

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,

Plaintiff,

V.

PHILIP MORRIS USA INC. (f/k/a
PHILIP MORRIS INCORPORATED), et
al.,

Defendants.

Civil Action No. 99-CV-2496 (GK)

Next Court Appearance:
Trial (Ongoing)

WRITTEN DIRECT TESTIMONY

OF

DAVID R. BERAN

Submitted by Joint Defendants Pursuant to Order #471

Table of Contents

Page

I.	BACKGROUND	1
A.	EDUCATIONAL BACKGROUND.....	1
B.	PHILIP MORRIS USA EMPLOYMENT HISTORY.....	1
C.	CURRENT POSITION: EXECUTIVE VICE PRESIDENT OF STRATEGY, COMMUNICATIONS AND CONSUMER CONTACT.....	5
D.	SENIOR TEAM.....	7
E.	OVERVIEW OF SIGNIFICANT AREAS OF INVOLVEMENT	8
II.	PHILIP MORRIS USA'S CIGARETTE BRAND MARKETING TODAY.....	8
III.	HOW DOES PHILIP MORRIS USA TARGET ITS CIGARETTE BRAND MARKETING?.....	13
A.	TARGETING.....	13
B.	PHILIP MORRIS USA DOES NOT MARKET ITS CIGARETTE BRANDS TO MINORS	14
C.	PHILIP MORRIS USA DOES NOT MARKET ITS CIGARETTE..... BRANDS TO NONSMOKERS	17
IV.	THE ROLE OF MARKET RESEARCH	17
A.	DEFINITION OF MARKETING.....	17
B.	MARKET RESEARCH DATA USED BY PHILIP MORRIS USA.....	18
C.	TYPES OF MARKET RESEARCH CONDUCTED FOR PHILIP MORRIS USA'S MARKETING DEPARTMENT	22
V.	OBJECTIVES OF PHILIP MORRIS USA'S CIGARETTE BRAND MARKETING.....	35
VI.	PHILIP MORRIS USA'S MARKETING OBJECTIVES JUSTIFY LARGE MARKETING EXPENDITURES.....	56
VII.	PHILIP MORRIS USA HAS BEEN SUCCESSFUL WITHOUT TARGETING NONSMOKERS	57
VIII.	PHILIP MORRIS USA'S DOCUMENTS CONTRADICT THE GOVERNMENT'S THEORIES ABOUT THE WAY PHILIP MORRIS USA CONDUCTS ITS BUSINESS	60
A.	PHILIP MORRIS USA'S MARKETING PLANNING DOCUMENTS	60
B.	PHILIP MORRIS USA'S MARKET RESEARCH DOCUMENTS	69
C.	PHILIP MORRIS USA'S BUSINESS PLANNING DOCUMENTS	70

Table of Contents
(continued)

	<u>Page</u>
D. DOCUMENTS CONTAINING DATA ON PERSONS UNDER THE AGE OF 18 DO NOT DEMONSTRATE THAT PHILIP MORRIS USA WAS TARGETING ITS MARKETING TO MINORS.....	72
IX. THE MARLBORO BRAND	74
X. MARKETING COMPLIANCE.....	77
A. VOLUNTARY CIGARETTE ADVERTISING CODE.....	78
B. LEGAL REVIEW OF MARKETING COMMUNICATIONS.....	80
XI. IMPACT OF THE MSA.....	81
A. MARKETING RESTRICTIONS IN THE MSA.....	81
B. MSA COMPLIANCE.....	83
XII. DECLINING AND DISAPPEARING PRINT PROFILE	86
XIII. PHILIP MORRIS USA'S ADULT SMOKER DATABASE	89
A. THE ADULT SMOKER DATABASE AND HOW IT IS POPULATED	90
B. CLASSIFICATION OF DATABASE NAMES.....	93
C. OVERVIEW OF EVOLUTION OF AGE VERIFICATION REQUIREMENTS.....	96
D. THIRD PARTY VERIFICATION OF AGE REQUIREMENTS.....	99
E. EFFORTS TO RE-CERTIFY EXISTING NAMES ON THE DATABASE	101
F. HOW CAN SMOKERS REMOVE THEIR NAMES FROM PHILIP MORRIS USA'S MAILING LIST?.....	104
G. THE GOVERNMENT'S QUERIES RUN ON THE ADULT SMOKER DATABASE	105
XIV. CONTINUITY PROGRAMS AND DIRECT MAIL	118
A. CONTINUITY PROGRAMS.....	118
B. DIRECT MAIL.....	120
XV. SPONSORSHIPS AND EVENT MARKETING.....	121
A. PRE-MSA SPONSORSHIPS	121
B. POST-MSA SPONSORSHIP OF MARLBORO TEAM PENSKE.....	122
C. PHILIP MORRIS USA'S EFFORTS TO REDUCE THE EXPOSURE OF ITS RACING SPONSORSHIP TO PERSONS WHO ARE UNDER LEGAL AGE	124
D. BAR NIGHTS.....	125

Table of Contents
(continued)

	<u>Page</u>
XVI. PRICE AND PRODUCT PROMOTIONS.....	126
A. OVERVIEW OF CIGARETTE PRICES: 1980s TO PRESENT.....	126
B. MARLBORO FRIDAY	131
C. PRICE AND PRODUCT PROMOTIONS.....	137
D. PRICE ELASTICITY	138
XVII. MARKETING OF LOW TAR CIGARETTES.....	144
A. BRAND DESCRIPTORS	144
B. THE IMPORTANCE OF TASTE	145
XVIII. PHILIP MORRIS USA'S RESPONSE TO PUBLIC HEALTH	
COMMUNITY CONCERNS ABOUT LOW TAR CIGARETTES.....	151
XIX. PHILIP MORRIS USA'S EFFORTS TO DEVELOP LESS HAZARDOUS	
CIGARETTES	155

1 I. BACKGROUND

2 A. EDUCATIONAL BACKGROUND

3 Q. What is your name?

4 A. David Raye Beran.

5 Q. Where are you employed, and what is your current position?

6 A. I am employed at Philip Morris USA Inc. (Philip Morris USA) as the Executive
7 Vice President of Strategy, Communications and Consumer Contact.

8 Q. How long have you worked for Philip Morris USA?

9 A. Since June of 1976.

10 Q. What is your educational background?

11 A. I graduated in 1976 from the University of Virginia with a Bachelor of Science
12 degree in Commerce with a major in Accounting. I then received my MBA in 1980 from
13 the University of Richmond. In 1980, I received my CMA certificate. In 1982, I
14 received my CPA certificate.

15 B. PHILIP MORRIS USA EMPLOYMENT HISTORY

16 Q. What was your first job out of college?

17 A. I started work for Philip Morris USA in June of 1976.

18 Q. What was your first position at Philip Morris USA?

19 A. I began in the Finance Department, working as a plant accountant.

20 Q. What were your responsibilities in that position?

21 A. Keeping track of the costs associated with manufacturing the product and
22 reporting that information back to the people running the plant.

23 Q. How long did you hold that position?

1 A. I worked in plant accounting, and then held various other positions in the Finance
2 Department until May of 1987. In May of 1987, I became the Director of Finance and
3 Planning.

4 Q. What were your responsibilities as Director of Finance and Planning?

5 A. I primarily worked on the Five Year Plan, which is the business plan for Philip
6 Morris USA. In addition, I was in charge of making sure that the day-to-day accounts
7 receivable from our customers were paid in a timely fashion.

8 Q. What did your work on the Five Year Plan entail?

9 A. It entailed gathering information from the various functional areas of the
10 company, such as marketing brand plans, financial forecasts, market research and sales
11 forecasts, to name a few. I then consolidated that information into a written Five Year
12 Plan.

13 Q. Are Five Year Plans prepared in the regular course of Philip Morris USA's
14 business?

15 A. Yes.

16 Q. What is JD-055103?

17 A. This is the 1989 Five Year Plan, which is a Five Year Plan I worked on.

18 Q. How long were you the Director of Finance and Planning?

19 A. I worked in that capacity for two years until I became Director of Research and
20 Planning in the Marketing Department in July of 1989. I was promoted to Vice President
21 of Marketing Research and Marketing Planning in 1990.

22 Q. What were your responsibilities in those positions?

1 A. My areas of responsibility grew during the course of my time in those positions.
2 Ultimately, I had four main areas of responsibility. One area was market research, where
3 I directed the department in conducting marketplace and consumer research. The second
4 area was marketing planning, where I was responsible for consolidating all the Brand
5 Plans and marketing spending into an overview for the Senior Vice President of
6 Marketing. The third area was new products, where I worked with the research and
7 development department on new products and line extensions. The fourth area was our
8 Adult Smoker Database group, which reported to me during the last half of that period.

9 Q. How long were you the Vice President of Marketing Research and Marketing
10 Planning?

11 A. I held that position until January of 1995, when I moved to the brand marketing
12 group.

13 Q. What positions did you hold in the brand marketing group?

14 A. In January of 1995, I was appointed Vice President of Discount Brands. In May
15 of 1996, I was appointed Vice President of Marlboro Promotions, a position I held until
16 1998.

17 Q. What were your responsibilities as Vice President of Discount Brands?

18 A. I was responsible for directing the marketing programs for our discount brands,
19 including Basic, Cambridge and Alpine. I oversaw the drafting of Brand Plans and the
20 execution of those plans.

21 Q. Who did you report to in that position?

22 A. I reported to the Senior Vice President of Marketing.

23 Q. What were your responsibilities as Vice President of Marlboro Promotions?

1 A. I was responsible for creating and executing the promotions for Marlboro,
2 including retail, continuity programs and direct mail.

3 Q. Who did you report to in that position?

4 A. I reported to the Group Vice President of Marlboro and New Products.

5 Q. What position did you take in 1998?

6 A. In February of 1998, I became Senior Vice President of Planning and Information.

7 Q. What were your responsibilities as Senior Vice President of Planning and
8 Information?

9 A. I oversaw three groups: Business Planning, Market Research and Information
10 Services. My responsibilities included overseeing preparation of the Five Year Plan,
11 providing marketplace intelligence to the company, and providing strategic direction to
12 the Information Technology group.

13 Q. What position did you hold next?

14 A. I served as Senior Vice President of Operations from October of 2000 until
15 September of 2002.

16 Q. What were your responsibilities as Senior Vice President of Operations?

17 A. I was in charge of the manufacturing and the research, development and
18 engineering functions at Philip Morris USA.

19 Q. What position did you assume in 2002?

20 A. In September of 2002, I was appointed to my present position as Executive Vice
21 President of Strategy, Communications and Consumer Contact.

22 Q. Before we talk about that position, let's talk about your compensation. What
23 is your current salary?

1 A. My current salary is \$586,600.

2 Q. Did you receive a bonus payment in 2005 for work done in 2004?

3 A. Yes. My bonus was \$690,000, which I received earlier this year.

4 Q. What other compensation will you receive this year?

5 A. I received a restricted stock award worth approximately \$1.2 million that vests in
6 three years. In addition, I will receive approximately \$226,000 in dividend payments
7 from the restricted stock awards I received this year and the previous two years. In
8 addition, the company makes a contribution to our deferred profit sharing plan; my award
9 this year was \$87,325. I also have the use of a company car. In addition, I participate in
10 company benefit plans, like medical, dental, vision, retirement and vacation.

11 C. CURRENT POSITION: EXECUTIVE VICE PRESIDENT OF
12 STRATEGY, COMMUNICATIONS AND CONSUMER CONTACT

13 Q. What are your responsibilities today as Executive Vice President of Strategy,
14 Communications and Consumer Contact?

15 A. My job involves facilitating the overall business planning process for Philip
16 Morris USA and overseeing our marketing efforts, market information and analysis
17 efforts, government affairs coordination, media affairs work, and our information
18 services group.

19 Q. In your position as Executive Vice President of Strategy, Communications
20 and Consumer Contact, who are your direct reports?

21 A. There are two Senior Vice Presidents and three Vice Presidents who report to me:
22 the Senior Vice President of Marketing; the Senior Vice President of Communications
23 and Government Affairs Coordination; the Vice President of Information Services; the

1 Vice President of Market Information and Analysis; and the Vice President of Business
2 Planning and Development.

3 Q. Can you describe the type of oversight you exercise with respect to the
4 Business Planning and Development Department?

5 A. Yes. Our Business Planning and Development Department is responsible for
6 pulling together the plans from the various functional areas of the company into a
7 comprehensive annual Five Year Plan. Part of what I do involves the analysis of
8 marketplace data that impacts our business strategy and planning. In addition, the
9 department is a focal point for exploring new business opportunities. We recognize that
10 in a declining industry such as ours, it will eventually be necessary for the company to
11 create new business opportunities outside of the cigarette category. The department also
12 provides people who are working their way up through the company with the opportunity
13 to gain a better perspective on how our business runs.

14 Q. Can you describe the type of oversight you exercise with respect to the
15 Market Information and Analysis Department?

16 A. Yes. The Market Information and Analysis Department focuses on what I think
17 of as two types of research: marketplace information and consumer insights.
18 Marketplace information encompasses the collection of data on things like marketplace
19 dynamics, market share and competitive activities, all of which tell us various things
20 about market trends and the overall performance of cigarette brands and companies in the
21 cigarette industry. Consumer insight, on the other hand, provides us with information
22 from adult smokers on why they purchase various cigarette brands and how they respond
23 to marketing communications. My role is one of oversight, which is to provide direction

1 to the group to make sure we are providing the appropriate marketplace information and
2 consumer insight necessary to run our business.

3 Q. Can you describe the type of oversight you exercise with respect to the
4 Marketing Department?

5 A. Yes. I oversee our marketing activities. In doing so, I rely on the Senior Vice
6 President of Marketing to manage the day-to-day running of our Marketing Department.
7 The Senior Vice President of Marketing then keeps me informed about what I need to
8 know concerning the work of the department. If something comes up that requires
9 additional attention, she and I will discuss it. If we are considering major shifts in
10 marketing strategy or policies, she and I will ordinarily work together to make decisions,
11 which we then present to the Chairman and CEO, Mike Szymanczyk, and the rest of the
12 Senior Team. Mr. Szymanczyk, of course, has ultimate authority to approve our
13 decisions.

14 D. SENIOR TEAM

15 Q. What is the Senior Team?

16 A. The Senior Team is a collection of leaders of those functional areas that have a
17 significant impact on the company. They are hand picked by the Chairman and CEO,
18 Mike Szymanczyk, to serve on the Senior Team.

19 Q. In what way does the Senior Team have input into business decisions at
20 Philip Morris USA?

21 A. The Senior Team operates on the premise that those leaders are better able to
22 make decisions in their respective areas if they are informed by what is going on in other

1 areas of the company. In other words, information sharing allows those of us on the
2 Senior Team to make informed decisions through collaboration.

3 Q. How often does the Senior Team meet?

4 A. We meet almost every week to review marketplace conditions and the day-to-day
5 operations of the business. In addition, we hold three meetings a year, about four to five
6 days each. The first meeting, which is held around March, is focused on specific topics
7 that might have an impact on our business in the future. The second meeting, held
8 around June, is devoted to personnel advancement and planning. And the third meeting,
9 held in the fall, is for purposes of setting major initiatives that the company will focus on
10 in the coming year.

11 Q. How long have you been a member of the Senior Team?

12 A. Since February of 1998.

13 E. OVERVIEW OF SIGNIFICANT AREAS OF INVOLVEMENT

14 Q. Over the course of your career at Philip Morris USA, can you summarize the
15 areas in which you have held management positions?

16 A. Yes. I have held management positions in finance and officer level positions in
17 brand marketing, market research, business planning and operations.

18 Q. Is it fair to say that you have significant knowledge about the broad array of
19 areas of the company in which you've worked?

20 A. Yes.

21 II. PHILIP MORRIS USA'S CIGARETTE BRAND MARKETING TODAY

22 Q. Please summarize your involvement with cigarette brand marketing
23 throughout your career at Philip Morris USA?

1 A. As Director of Finance and Planning from 1987 to 1989, I had responsibility for
2 the annual drafting of Philip Morris USA's Five Year Plans. In the course of drafting the
3 competitive intelligence and marketing sections of those plans, I would review the Brand
4 Plans drafted by the Marketing Department. As a result, I became familiar with the
5 competitive analysis that the Marketing Department would engage in as part of its
6 business planning, as well as the marketing plans and strategies that were drafted by the
7 Marketing Department. In 1989, after I moved to Market Research and Planning, I
8 reported to the head of the Marketing Department and worked directly with the brand
9 group in order to design research that would support the goals and strategies for
10 marketing our cigarette brands. I also led the planning function for the Marketing
11 Department. I was also responsible for coordinating new product development with our
12 Product Development group in R&D. In addition, the Database group reported up
13 through me. During my time in the brand marketing group, from 1995 to 1998, I was
14 involved with the marketing of our discount brands and our Marlboro brand. As a
15 member of the Senior Team since 1998, I have remained informed about and involved in
16 the company's marketing decisions and activities. In my present position, I oversee the
17 work of the Marketing Department.

18 Q. During the time you have been involved with marketing at Philip Morris
19 USA, have you witnessed any changes to the way in which Philip Morris USA
20 markets its cigarettes?

21 A. Yes, there have been a number of very significant changes.

22 Q. What is the nature of those changes?

1 A. There are two major areas in which there have been changes. First, we have made
2 changes to our marketing practices based on the terms of the Master Settlement
3 Agreement. Second, we have made voluntary changes that go beyond what is required
4 by the Master Settlement Agreement.

5 Q. First, I would like to ask you about the changes Philip Morris USA has made
6 based on the MSA. Let me show you JDEM-040010. What does this demonstrative
7 show?

8 A. This demonstrative shows the marketing practices that are prohibited by the MSA.



10 Q. Does Philip Morris USA use cartoons to advertise its cigarette brands?

11 A. No.

1 Q. Does Philip Morris USA advertise its cigarette brands on billboards, in
2 stadiums or in transit locations?

3 A. No. We are no longer permitted to advertise on billboards. We also cannot
4 advertise in stadiums and arenas, on buses, taxicabs, or other transit locations. We have
5 some signage as part of our sponsorship of the Marlboro Team Penske entry in the Indy
6 Racing League, but that is strictly regulated by the sponsorship provisions of the MSA.

7 Q. Does Philip Morris USA pay to have its cigarette brands portrayed on
8 television or in movies?

9 A. No. In fact, we have recently worked to encourage the major studios not to depict
10 our products in their television shows or movies.

11 Q. Since the entry of the MSA, has Philip Morris USA sponsored any concerts
12 or other musical events on the behalf of any cigarette brand that are open to the
13 general public?

14 A. No.

15 Q. If Philip Morris USA hosts a musical event as part of its marketing activities,
16 is the musical event limited to adults over the age of 21?

17 A. Yes. If Philip Morris USA hosts a musical event, it is an invitation-only event to
18 which we will invite adult smokers 21 years of age and older who are on our Database.

19 Q. Does Philip Morris USA distribute hats, or t-shirts or jackets with cigarette
20 brand names or logos?

21 A. No.

22 Q. Does Philip Morris USA have any brand name sponsorships?

1 A. Yes. We are limited to a single brand sponsorship under the MSA, and we have
2 chosen to sponsor the Marlboro Team Penske entry in the Indy Racing League.

3 Q. Does Philip Morris USA distribute free samples of cigarettes to smokers?

4 A. No. In fact, we stopped consumer sampling in 1995 as part of our Action Against
5 Access program.

6 Q. In addition to the marketing restrictions set forth in the MSA, has Philip
7 Morris USA made any additional changes to its cigarette brand marketing
8 practices?

9 A. Yes. For example, we have made some changes to our media placement policy
10 for magazines.

11 Q. Does Philip Morris USA advertise its cigarette brands in magazines?

12 A. No. As of 2004, Philip Morris USA is not running any cigarette brand advertising
13 in national magazines.

14 Q. Overall, how would you describe the changes to Philip Morris USA's
15 cigarette brand marketing in the past seven years?

16 A. I would describe it as a continuing evolution toward reducing the overall profile
17 of cigarette advertising and focusing on more targeted and direct communications with
18 adult smokers. In doing so, we live by both the letter and spirit of our commitments, such
19 as the MSA. This is an important part of our mission to be the most responsible marketer
20 of tobacco products and guides every one of our marketing strategies, tactics and
21 decisions. It is also an evolution that has dramatically changed the way we market our
22 cigarette brands.

1 III. HOW DOES PHILIP MORRIS USA TARGET ITS CIGARETTE BRAND
2 MARKETING?

3 A. TARGETING

4 Q. Is "targeting" a term that has meaning for you as someone who has
5 marketed cigarette brands?

6 A. Yes. Marketing is all about targeting.

7 Q. Can you explain what you mean?

8 A. "Targeting" is really just another word for the way in which you direct your
9 marketing efforts to reach a particular audience.

10 Q. What groups does Philip Morris USA target with its cigarette brand
11 marketing?

12 A. Adult smokers. Beyond that, it can be broken down in a myriad of ways,
13 depending on the program and the brand. For example, we might target certain types of
14 marketing to adult smokers between the ages of 24-34, to menthol adult smokers, to adult
15 smokers who enjoy Indy racing, or to competitive brand adult smokers who only
16 purchase our brands on an alternate basis. Most likely, it will be some combination of
17 factors. That is the goal of marketing: to identify what different adult smokers want and
18 to try to design marketing programs that will connect with those adult smokers in relevant
19 ways.

20 Q. When you target cigarette brand marketing to a particular group of adult
21 smokers, how can you be sure that others -- who are not in your target group -- will
22 not be exposed to your marketing as well?

23 A. You cannot. Marketing is not a science. You can do your best to focus your
24 efforts on a target group, but it is almost inevitable that some persons outside that group

1 will also see your communications. That is one reason why in recent years Philip Morris
2 USA has substantially reduced its cigarette brand marketing activities.

3 B. PHILIP MORRIS USA DOES NOT MARKET ITS CIGARETTE BRANDS
4 TO MINORS

5 Q. What is the minimum age of the target group for Philip Morris USA's
6 cigarette brand marketing efforts?

7 A. Philip Morris USA's cigarette brand marketing is targeted to adult smokers who
8 are legal age and older. We do not market to anyone under the age of 18.

9 Q. Are all of Philip Morris USA's marketing efforts targeted to adult smokers
10 legal age and older?

11 A. Yes, in fact all of our marketing programs are targeted to smokers 21 years of age
12 or older, with the exception of retail promotions, which are directed to smokers legal age
13 or older.

14 Q. Why do you target all non-retail marketing programs to smokers 21 years of
15 age and older when the legal age is lower?

16 A. We have attempted to add an extra buffer in an effort to limit the exposure of
17 minors to our marketing communications and programs.

18 Q. Let me show you JDEM-040326. Is this a demonstrative exhibit prepared at
19 your direction to illustrate your point?

20 A. Yes.

Philip Morris USA's Marketing Programs		
	Marketing Program	Minimum Age For Target Audience
	Direct Mail	21
	Experiential Programs	21
	Sweepstakes	21
	Continuity Programs	21
	Retail Price and Product Promotions	Legal Age by State Law

JCEM-040537

Q. What does this demonstrative show?

A. It sets forth the types of marketing programs we have today, along with the minimum age of the target audience for each.

Q. By the way, Mr. Beran, the demonstrative refers to legal age by state law. What does this reference?

A. Each state sets its own minimum smoking age. The legal age is 18 except in the following locations: in Alabama, Alaska and Utah, the legal age is 19; in certain localities in Massachusetts, the legal age is 20.

Q. Has Philip Morris USA ever had a policy that, overall, its marketing efforts would only be directed at smokers 21 years of age and older?

1 A. No. As I explained, while most of our programs are limited to smokers, 21 years
2 of age and older, some are limited to smokers of legal age and older.

3 Q. If someone at Philip Morris USA wrote in a document that the company's
4 policy was that its marketing is only directed at smokers 21 years of age and older,
5 would they be wrong?

6 A. If they were attempting to set forth the overall age of our target audience, yes,
7 they would be wrong. But obviously I would want to see the document in order to look
8 at the context for their statement. For example, there are documents written about our
9 continuity programs, our smoker database or about some of our events, which would
10 correctly talk about restricting the target audience to smokers 21 and older.

11 Q. Mr. Beran, are you aware of the allegation that Philip Morris USA markets
12 to minors?

13 A. Yes, I am.

14 Q. I am going to direct your attention to the testimony of one of the
15 Government's expert witnesses, Anthony Biglan. Dr. Biglan testified that Philip
16 Morris USA markets its Marlboro, Virginia Slims and Parliament brands to appeal
17 to the psychological needs of adolescents and motivate them to start smoking.

18 [A.Biglan, Written Direct Testimony, 53:3-14] Do you agree with this testimony?

19 A. Absolutely not. We do not market any of our cigarette brands to nonsmokers or
20 to anyone underage.

21 Q. In your many years at Philip Morris USA working on planning and
22 strategies, have you ever seen any Philip Morris USA plan or strategy to market
23 cigarette brands to minors?

1 A. No.

2 C. PHILIP MORRIS USA DOES NOT MARKET ITS CIGARETTE BRANDS
3 TO NONSMOKERS

4 Q. Does Philip Morris USA's over all target audience include nonsmokers?

5 A. No.

6 Q. I am going to direct your attention to the testimony of another one of the
7 Government's expert witnesses, Robert Dolan. Dr. Dolan testified that Philip
8 Morris USA targeted "starters" with its marketing because it "needed new people
9 to replace those leaving the market due to death or quitting." [R. Dolan, Written
10 Direct Testimony, 75:2-5.] Do you agree with this testimony?

11 A. No. It is incorrect. Philip Morris USA does not target "starters" with its cigarette
12 brand marketing. We target our cigarette brand marketing only to existing smokers.

13 Q. In your many years at Philip Morris USA working on planning and
14 strategies, have you ever seen any Philip Morris USA plan or strategy to market
15 cigarette brands to nonsmokers?

16 A. No.

17 IV. THE ROLE OF MARKET RESEARCH

18 A. DEFINITION OF MARKETING

19 Q. What is included under the general heading of marketing?

20 A. Everything that is required in order to get a product to market, including market
21 research, product development, advertising and promotions.

22 Q. What is the role of marketing at Philip Morris USA?

23 A. The role of marketing is to responsibly and profitably connect to adult smokers.

1 Q. Is marketing a simple matter of finding compelling images and themes for
2 your brands and spending a lot of money to expose your marketing to as many
3 people as possible?

4 A. No. It's more complicated than that. It is important to understand the target
5 market and to understand what your consumers want and why. In our case, that means
6 understanding the cigarette market and understanding adult smokers' purchase decisions.
7 It is important to understand, both for the adult smokers who choose our brands and the
8 adult smokers who choose competitive brands, what motivates them to purchase one
9 brand over another. Then it is our job to make sure that our product lineup offers the
10 choices that adult smokers want, that our marketing programs motivate our adult smokers
11 to purchase Philip Morris USA brands instead of competitive brands and that our
12 marketing programs motivate competitive adult smokers to purchase Philip Morris USA
13 brands instead.

14 Q. How do you gain an understanding of the cigarette market and adult
15 smokers' purchase decisions?

16 A. We gather data on the market and we talk to adult smokers.

17 Q. What is that process called?

18 A. It's called market research.

19 B. MARKET RESEARCH DATA USED BY PHILIP MORRIS USA

20 Q. Can you explain what market research is?

21 A. It's an effort to understand your market – in our case, the U.S. cigarette market.

22 It's also an effort to understand your consumer – in our case, adult smokers.

1 Q. What types of market research data does Philip Morris USA utilize for these
2 purposes?

3 A. We collect marketplace data that helps us to understand how our brands are
4 performing and how we are competing with other companies' brands. We also rely on
5 consumer research that helps us to understand adult smokers and what motivates their
6 brand choices. In addition, we test marketing ideas and images with adult smokers.

7 Q. Have you helped to prepare a demonstrative concerning the types of market
8 research data relied upon by Philip Morris USA? JDEM-040327.

9 A. Yes, I have.



10
11 Q. What does this demonstrative show?

1 A. This demonstrative sets forth the three main types of market research data we rely
2 on: marketplace data, consumer research among adult smokers and testing marketing
3 ideas with adult smokers.

4 Q. Let's take those one at a time. What types of marketplace data does Philip
5 Morris USA utilize?

6 A. We utilize a great deal of marketplace data, but there are three main types of
7 marketplace data that we receive on a regular basis. We receive shipment information
8 compiled by a company called Management Science Associates on the number of
9 cigarettes that the major manufacturers ship to wholesalers. We also receive weekly
10 information compiled by a company called IRI-Capstone. Their report gives us
11 information on what is taking place at retail, including what brands smokers are buying at
12 retail and at what price. IRI-Capstone does not measure share from nonretail sources
13 such as internet, direct mail and other nonretail segments. Finally, we receive switching,
14 alternate purchasing and other information from our Continuous Adult Smoker Tracking
15 Study, which we call CASTS.

16 Q. I want to ask you a bit later about market share, switching and alternate
17 purchasing. But for now, just generally, why is information on share, switching and
18 alternate purchasing important?

19 A. We operate in a declining industry. Therefore, it is particularly important that we
20 both defend our share and gain incremental share from our competitors.

21 Q. What types of market research data does the Marketing Department utilize
22 to try to understand adult smokers' brand choices?

1 A. We use different forms of market research data, but it all boils down to
2 understanding why adult smokers choose one brand over another and learning what we
3 can offer adult smokers so that they will choose our brands instead of competitive brands.
4 For example, only after we understand why adult smokers choose Camel instead of
5 Marlboro can we develop a strategy to convince them to try Marlboro. For those adult
6 smokers who have tried Marlboro, we want to learn how we can convince them to
7 purchase Marlboro more often instead of competitive brands, like by offering a "buy one
8 get one free" product promotion. Ultimately, of course, we want to learn ways that we
9 might convince those adult smokers to switch to Marlboro as their regular brand.
10 Conversely, only if we understand why Marlboro adult smokers are loyal to Marlboro can
11 we make sure that our marketing reinforces that brand loyalty. We want to learn what
12 Marlboro adult smokers like about their brand so that we can try to provide that to them
13 on a consistent basis. Those are just a few examples.

14 Q. How does Philip Morris USA test its marketing ideas and images with adult
15 smokers?

16 A. It depends on what we are testing. For example, if we are introducing a line
17 extension of a brand that is already on the market, we might test the name for that line
18 extension, or we might test different colors for the pack. If we are testing items that we
19 are considering for a continuity program, we might show adult smokers examples of the
20 items.

21 Q. Does your Marketing Department use the types of market research data you
22 just described?

23 A. Yes.

1 C. TYPES OF MARKET RESEARCH CONDUCTED FOR PHILIP MORRIS
2 USA'S MARKETING DEPARTMENT

3 Q. How is market research conducted for the Philip Morris USA Marketing
4 Department?

5 A. Generally, the research for the Marketing Department is coordinated through our
6 Marketing Information and Analysis Department.

7 Q. Are any other groups or entities involved in conducting market research for
8 the Philip Morris USA Marketing Department?

9 A. Yes. Our advertising agencies conduct research and idea development for
10 possible use in our marketing programs. Frequently, idea development is spontaneous
11 within the agency and may be presented to us, after the fact, for consideration to
12 determine if it is consistent with our marketing goals and practices. In addition, product
13 development research conducted by our Research and Development group may be used
14 by our Marketing Department.

15 Q. Can you describe the role Philip Morris USA's Marketing Information and
16 Analysis Department plays in coordinating research for the Marketing
17 Department?

18 A. Our Market Information and Analysis Department, usually upon request by the
19 Marketing Department but sometimes on their own initiative, generates research to
20 support our marketing programs. This research can include quantitative research, such as
21 Ad Pack studies, or qualitative research, such as focus groups. All of this research is
22 conducted by outside vendors, using Philip Morris USA guidelines. Our Market
23 Information Department also purchases syndicated research conducted by others.

1 Q. With respect to the research conducted for the Philip Morris USA Marketing
2 Department, what is the minimum age for participants in that market research?

3 A. Philip Morris USA's policy is to conduct market research for the Marketing
4 Department only among persons who are 18 years of age and older. In addition, as some
5 states increased their minimum age laws over the age of 18, we have followed those
6 higher minimum ages for the market research conducted in those states. Subject to those
7 rules, the age of the research participants could vary depending on the purpose of the
8 research. If the marketing program the research was being conducted for was limited to
9 smokers 21 years of age and older, then the research for that program was also limited to
10 smokers 21 years of age and older. If the research was being conducted to test cigarette
11 packaging or advertising, it was limited to smokers legal age and older. Earlier this year,
12 we analyzed the market research we actually conduct today, and discovered that we do
13 little market research with legal age smokers under the age of 21. Accordingly, I
14 implemented a decision on February 22, 2005, to simplify our policy. Today, we limit
15 our market research to smokers 21 years of age and older, with the exception of our
16 smoker tracking (CASTS) and Prevalence Tracking, which are still limited to smokers
17 legal age and older. Even though we have restricted our market research in this way,
18 Philip Morris USA has the right to market its cigarette brands to smokers of legal age.

19 Q. Why did Philip Morris USA not also limit CASTS and Prevalence Tracking
20 to adult smokers 21 years of age and older?

21 A. Because CASTS and Prevalence Tracking are intended to be market
22 measurements, and in our overall market, including retail, is adult smokers, legal age and
23 older.

1 Q. Does Philip Morris USA conduct any cigarette brand marketing research
2 among anyone under legal age?

3 A. No.

4 Q. Does Philip Morris USA conduct any cigarette brand marketing research
5 among anyone who is not a smoker?

6 A. No.

7 Q. I would like to focus you on the Continuous Adult Smoker Tracking Study,
8 which you have referred to as CASTS. Please describe CASTS.

9 A. The Continuous Adult Smoker Tracking Study gathers information from adult
10 smokers legal age and older through random digit dialing telephone calls done
11 nationwide. We use two vendors that specialize in this type of survey to contact adult
12 smokers by telephone and ask them a series of questions. Philip Morris USA began the
13 Tracking Study around 1970, though at that time, we only contacted adult smokers
14 quarterly. Since 1988, the Tracking Study has been continuous, meaning that we contact
15 adult smokers almost every day of the year, with the exception of a few holidays.

16 Q. Why does Philip Morris USA conduct CASTS?

17 A. It provides us with important information on how our brands are doing. Adult
18 smokers tell us: [a] what brand they consider to be their regular brand; and [b] whether
19 they buy their regular brand 100 percent of the time, or whether they buy other brands on
20 occasion. If adult smokers do not buy their regular brand 100 percent of the time, they
21 tell us what other brands they are buying, and the percentage of that alternate purchasing.
22 In addition, it provides us with the percentage of switchers in the market and it tells us

1 what brands switchers are moving to. Those are just some examples. This information is
2 very useful to Philip Morris USA in planning and executing its marketing activities.

3 Q. How many adult smokers does Philip Morris USA talk to as part of CASTS?

4 A. It has ranged from 2000 to 6000 adult smokers per month. Today, our vendors
5 speak with 4000 smokers legal age and older every month.

6 Q. How do the vendors know who to call?

7 A. The survey companies conduct random-digit dialing, which means that a
8 computer randomly dials telephone numbers throughout the country.

9 Q. If telephone numbers are dialed randomly, how do the vendors make sure
10 they are only talking to smokers who are legal age and older?

11 A. They have a script they are required to follow, which includes screening questions
12 to make sure they are talking to a legal age smoker.

13 Q. Are the CASTS vendors instructed to ask to speak with young adult male
14 smokers between the ages of 18 to 24?

15 A. Yes, sometimes, but only for the purpose of making sure we speak with a
16 representative number of adult smokers from that age and sex cohort. We have found
17 over the years that young adult male smokers between the ages of 18 to 24 are the hardest
18 to reach via telephone survey because they do not spend a lot of time at home. As a
19 result, our vendor has a hard time speaking with a representative sample of these
20 smokers. In an effort to address this problem, the vendors instruct their interviewers to
21 ask to speak, if possible, with the youngest adult male smoker in the household.
22 However, this instruction is only in place to ensure that the calls yield a representative
23 sample of young adult male smokers ages 18-24. Once the vendor believes that it has a

1 representative sample of this cohort, this instruction no longer applies. Indeed, if the
2 vendor finds that any other cohort is underrepresented, they will instruct their
3 interviewers to ask to speak with adult smokers in that cohort for the same reason.

4 Q. What types of questions does Philip Morris USA ask adult smokers as part of
5 CASTS?

6 A. There is a core module of questions that has remained fairly consistent over the
7 years. This is part of the reason the study is valuable as a tool for tracking adult smoker
8 purchasing behavior. This core module asks adult smokers a variety of questions,
9 including their regular brand of cigarettes, whether they have switched regular brands in
10 the last year, whether they purchase brands other than their regular brand, what other
11 brands they purchase and how often, why they purchase brands other than their regular
12 brand and whether they purchase cigarettes by the pack or the carton. In addition, over
13 the years various modules have been added over short periods of time to address a variety
14 of topics. For example, Philip Morris USA might, for a period of time, solicit feedback
15 on a new cigarette brand introduction.

16 Q. Does CASTS provide Philip Morris USA with brand loyalty information?

17 A. Yes, it does.

18 Q. How does Philip Morris USA define a Philip Morris USA brand loyal
19 smoker?

20 A. The most brand loyal Philip Morris USA adult smokers are those who tell us that
21 a Philip Morris USA cigarette brand is their regular brand and that they purchase that
22 brand 100 percent of the time.

23 Q. How important is brand loyalty to Philip Morris USA?

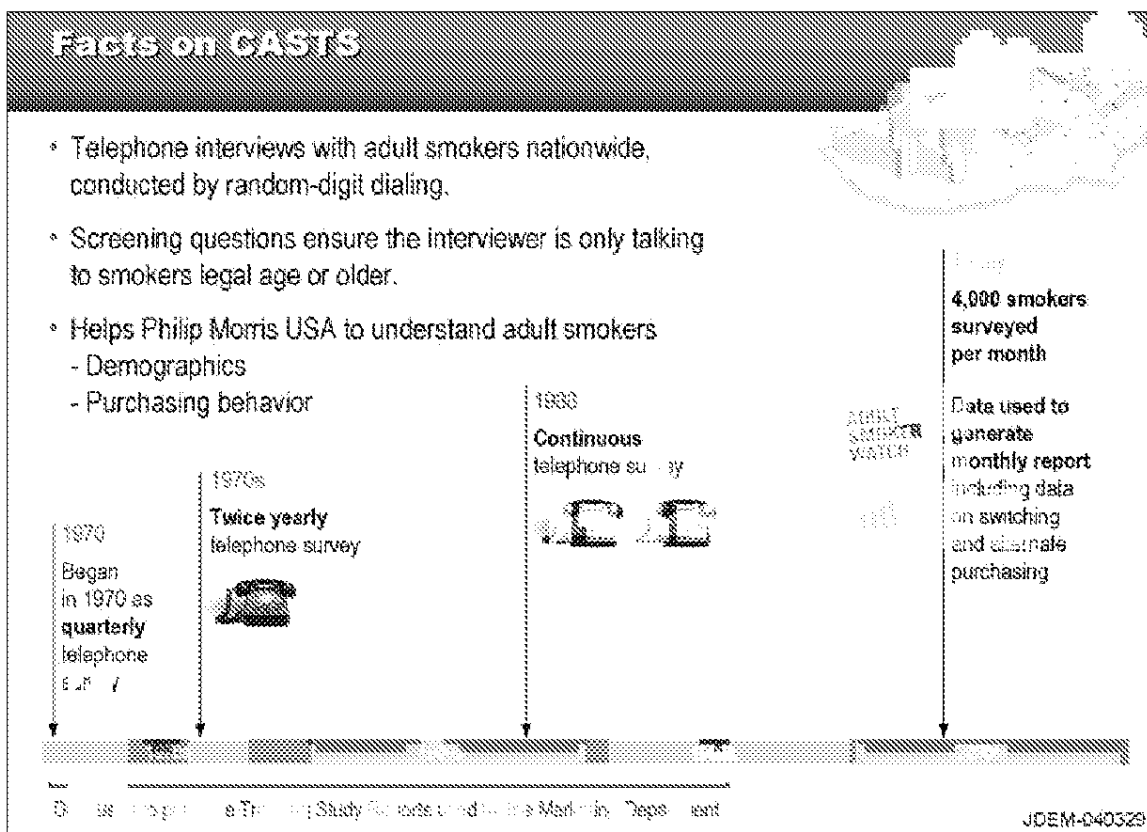
1 A. It is extremely important. We cannot take it for granted that adult smokers will
2 continue to choose Philip Morris USA brands. If we do not focus on brand loyalty, we
3 risk losing market share. As an example, if Philip Morris USA were to lose one market
4 share point, Philip Morris USA would have lost approximately \$155 million in income.
5 Every time an adult smoker purchases a pack of cigarettes, he or she is making a decision
6 about what brand to buy. And every time they make that decision, there is a possibility,
7 for a variety of reasons, that they will choose a competitor's brand. Today, many adult
8 smokers buy cigarettes by the pack rather than by the carton. That means that instead of
9 purchasing cigarettes 35-40 times a year, many adult smokers buy cigarettes on a daily
10 basis. Because adult smokers are making purchase decisions every day, we have to
11 defend our brands every day.

12 Q. Would you please explain to the Court what Philip Morris USA learns from
13 CASTS about brand loyalty?

14 A. It basically tells us where we are with respect to brand loyalty and gives us
15 information about some of the reasons why adult smokers choose to purchase brands
16 other than their own and how often they do so.

17 Q. Let me show you JDEM-040329. Would you please tell the Court what this
18 is?

19 A. This is a summary of important points regarding CASTS prepared at my
20 direction. It shows how long we have been conducting CASTS, the requirements for
21 persons who are interviewed for CASTS and the types of information CASTS provides to
22 Philip Morris USA.



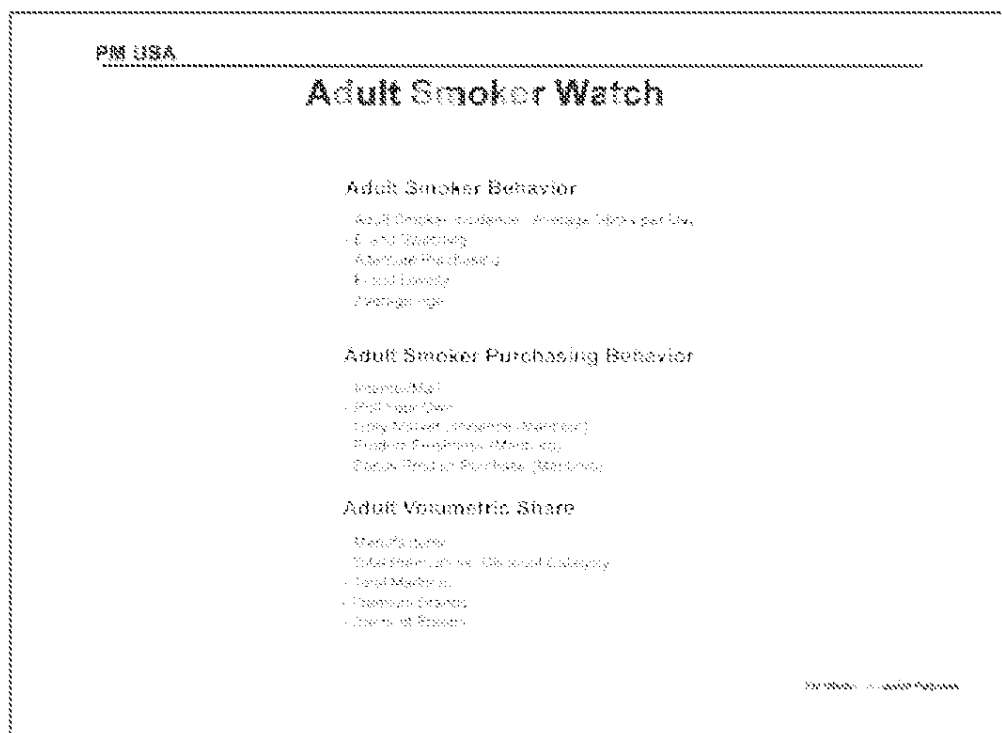
Q. Does the CASTS data get reported in some form?

A. Yes. From the start of CASTS until around 1995, there were regular Tracking Study Reports, which were usually quite voluminous. Around 1996, we made the decision to stop publishing regular written reports, because those persons within the company that utilized CASTS data could access that data on their computers. Recently, we began generating our Adult Smoker Watch Report, which includes brand switching and alternate purchasing data.

Q. Do these reports make it clear that Philip Morris USA only tracks adult smokers?

A. Yes.

1 Q. I would like to focus you on some actual examples. Let me show you
2 documents marked as JD-053363 and JD-053375. What are these documents?
3 A. These are examples of Adult Smoker Watch Reports. JD-053363 is dated
4 January, 2003 and JD-053375 is dated March, 2004.
5 Q. What is the Adult Smoker Watch Report?
6 A. The Adult Smoker Watch Report is a report we prepare to help us monitor our
7 business and make marketing decisions.
8 Q. Is it prepared in the regular course of Philip Morris USA's business?
9 A. Yes.
10 Q. Before we proceed, I want to ask you about the exhibits we will be discussing.
11 Have you reviewed each of the exhibits referred to in this examination?
12 A. Yes.
13 Q. For the exhibits that are Philip Morris USA documents, were each of these
14 documents prepared and maintained in the regular course of Philip Morris USA's
15 business?
16 A. Yes.
17 Q. Turning back to JD-053363, what information is contained within the
18 report?
19 A. If you look to the table of contents on page 2 of JD-053363, for example, you will
20 see the categories of information that are included:



1

2 Q. You testified that the report is a critical tool for your business. Please help
3 the Court understand how you use it in your business.

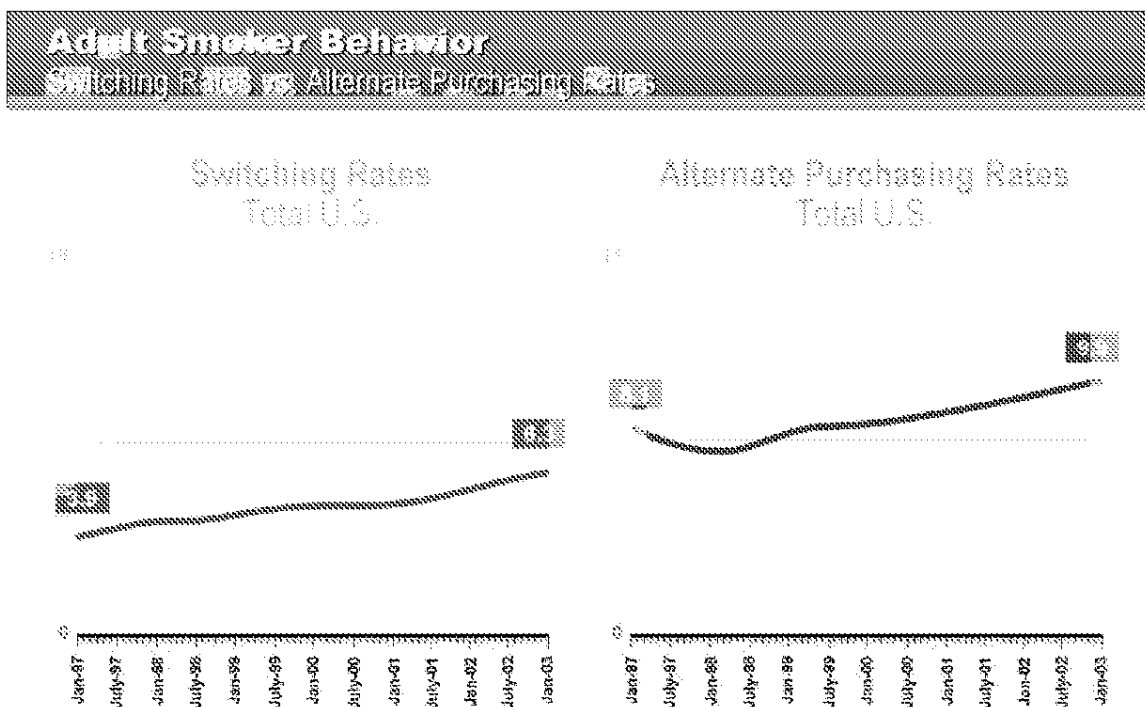
4 A. Reports such as this one help us monitor brand loyalty. For example, on JD-
5 053363, if you turn to page Bates number PM 3002955914, you can determine the
6 percentage of adult smokers who switched from one brand to another in 2002. In
7 addition, at page Bates number 3002955916, you can also see the percentage of volume
8 that smokers purchased of cigarettes that were not their regular brand during that year.

9 Q. Have you prepared a demonstrative that illustrates the brand switching and
10 alternate purchase rates contained in JD-053363?

11 A. Yes, I have.

1 Q. Let me show you JDEM-040353. Is this a demonstrative showing brand
2 switching and alternate purchase rates based on JD-053363?

3 A. Yes.



4 JD-053363

JDEM-040353

5 Q. Do these reports also give you reasons why adult smokers make these
6 decisions?

7 A. Yes.

8 Q. Mr. Beran, before we leave JD-053363 and JD-053375, I would like you to
9 review both of those reports in their entirety. Is there anywhere in those reports
10 where Philip Morris USA analyzes, collects or tracks data for anyone under the
11 legal age to purchase cigarettes?

12 A. No.

1 Q. Is there anywhere in those reports where Philip Morris USA analyzes,
2 collects or tracks data for anyone who is not a smoker?

3 A. No.

4 Q. Let's turn to another example of the reports that set forth data collected by
5 CASTS. Let me show you JD-055057. What is this document?

6 A. This is the Consumer Tracking Study Report for the 12 months ending June,
7 1990.

8 Q. What is the Consumer Tracking Study Report?

9 A. This report is a predecessor of our current Adult Smoker Watch Report. As I
10 mentioned earlier, this type of report was prepared to help us monitor our business and
11 make marketing decisions.

12 Q. Was it prepared in the regular course of Philip Morris USA's business?

13 A. Yes.

14 Q. What information is contained within the report?

15 A. If you look to the table of contents – which can be found on the first eight pages
16 of the report – you will see that the report includes among other topics the following
17 information:

18 Industry Demographics

19 Company share of smokers
20 Demographic Profiles

21 Philip Morris Demographics

22 Brand Shares
23 Packing Shares
24 Median Age by Brand

25 Competitive Demographics

1 Brand Shares
2 Packing Shares
3 Median Age by Brand

4 Generics

5 Store Brands
6 Branded Generics

7 Q. Please help the Court understand how Philip Morris USA used this type of
8 report?

9 A. For example, on page 9 of the report, it lists the leading packings and their
10 relative share among men and women. One can note that the most popular packings for
11 men are different than the most popular packings for women both in rank and size. Thus,
12 this type of information would provide additional insight to the Marketing Department as
13 they developed their marketing strategies for the year.

14 Q. So what other information is found in this report?

15 A. If you go to Table 8 (page 1 of 3), which is found at the page bearing Bates Stamp
16 number ending in 9031, you will see broad industry category shares by men, women, and
17 age cohorts ranging from adult smokers age 18 to 21 through adult smokers age 65 plus.
18 For example, these broad industry categories include non-menthol and menthol brands,
19 full flavor and low-tar categories and price value categories.

1 Q. Is there anywhere in that report where Philip Morris USA analyzes, collects
2 or tracks data for anyone who is not a smoker?

3 A. No.

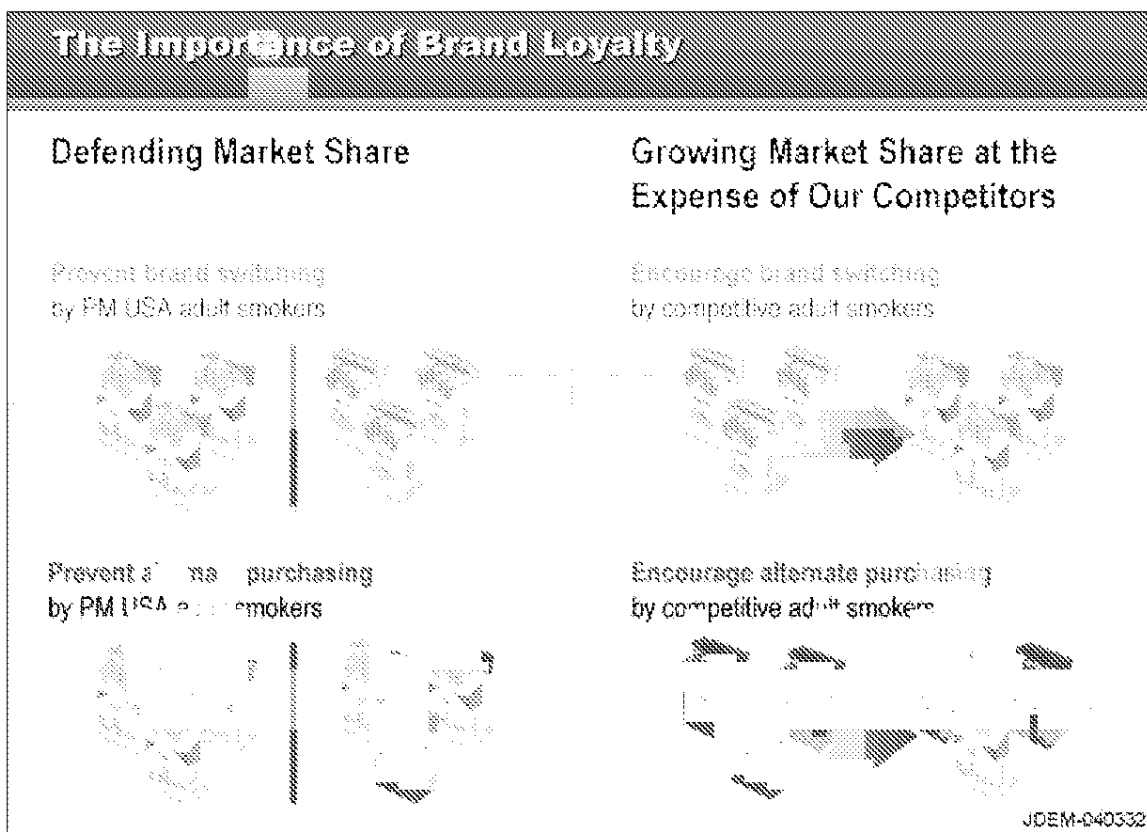
4 V. OBJECTIVES OF PHILIP MORRIS USA'S CIGARETTE BRAND
5 MARKETING

6 Q. Can you explain the objectives of Philip Morris USA's cigarette brand
7 marketing?

8 A. As I said earlier, the role of marketing is to responsibly and profitably connect
9 with adult smokers. To do this we focus on brand loyalty. Because Philip Morris USA is
10 the market leader in an intensely competitive and declining market, it is critical to
11 maintain brand loyalty and its market position. Today, Philip Morris USA has almost 50
12 percent of the overall retail market as measured by IRI-Capstone. We want to retain that
13 market share. The Marlboro brand today holds almost 40 percent of this retail market
14 share. That makes it a big target for our competitors, who would like to take some of that
15 market share away from Marlboro. As I stated above, if Philip Morris USA loses one
16 market share point, Philip Morris USA would have lost income of approximately \$155
17 million. Thus, defending our market share of adult smokers who continue to smoke and
18 currently choose our brands is our primary marketing objective. In addition, to the extent
19 possible, we would like to convert adult smokers of competitive brands to our brands,
20 thereby growing market share at the expense of our competitors.

21 Q. Have you helped to prepare a demonstrative illustrating what you just
22 described? JDEM-040332.

23 A. Yes, I have.



1

2 Q. What does this demonstrative show?

3 A. This demonstrative shows the importance of brand loyalty in marketing our
 4 cigarette brands. Philip Morris USA's primary marketing objective is to defend our
 5 market share. Our secondary objective is to grow market share at the expense of our
 6 competitors. This demonstrative depicts the roles that brand loyalty, brand switching and
 7 alternate purchasing play in furtherance of those objectives.

8 Q. What does Philip Morris USA do to defend its market share?

9 A. Broadly speaking, we focus on trying to prevent our adult smokers from
 10 switching to non-Philip Morris USA brands and from making alternate purchases of
 11 competitive cigarette brands.

12 Q. What is brand switching?

1 A. Most adult smokers have a brand that, when asked, they will tell you is their
2 regular brand. Brand switching occurs when a smoker switches from one brand to
3 another as his regular brand.

4 Q. How does switching relate to Philip Morris USA's primary objective of
5 defending its market share?

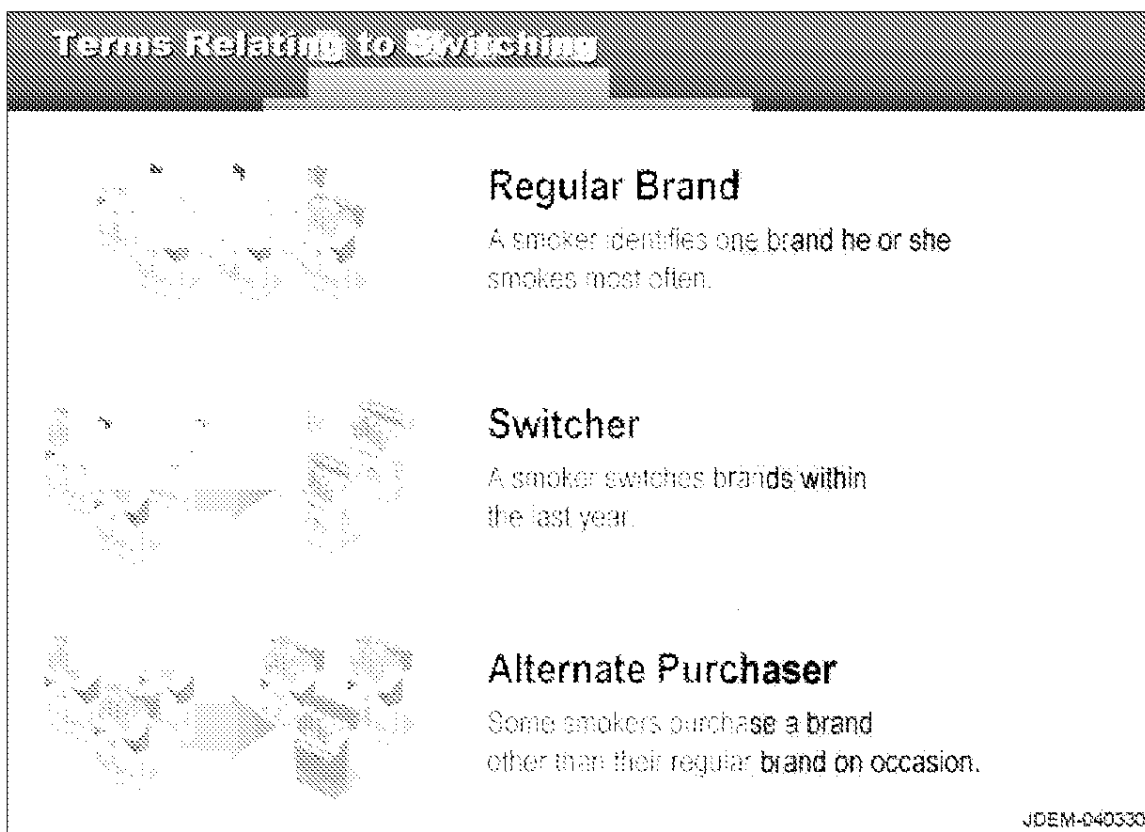
6 A. We want to keep current Philip Morris USA adult smokers from switching to a
7 competitive brand. So, for example, if an adult smoker has chosen Marlboro as his
8 regular brand, we do not want him to switch to Winston or Newport as his regular brand.

9 Q. What is alternate purchasing?

10 A. Just because an adult smoker has a brand that he considers to be his regular brand,
11 you cannot assume that he buys his regular brand 100 percent of the time. Sometimes he
12 might purchase an alternate brand instead. For example, even if an adult smoker
13 considers Marlboro his regular brand, he may not buy Marlboro 100 percent of the time.
14 He may, on occasion, purchase another brand. That is called alternate purchasing.

15 Q. Have you helped to prepare a demonstrative concerning brand switching and
16 alternate purchasing? JDEM-040330.

17 A. Yes, I have.



1

2 Q. What does this demonstrative show?

3 A. This demonstrative illustrates the difference between brand switching and
4 alternate purchasing.

5 Q. What are some of the reasons for alternate purchases?

6 A. Adult smokers tell us a number of reasons why they do not always purchase their
7 regular brand. For example, an adult smoker might buy their regular brand most of the
8 time, but they are willing to purchase other brands if they can take advantage of a coupon
9 or another promotion. As another example, their regular brand may be out of stock at the
10 store they visit to purchase cigarettes. Some adult smokers will travel to another store to
11 buy their brand, but others will have an alternate brand that they are willing to buy in a
12 situation like that. We know that some adult smokers cannot afford to smoke a premium

1 brand, like Marlboro or Virginia Slims, all the time. So an adult smoker in that situation
2 might purchase a discount brand occasionally during the week. Sometimes a smoker just
3 wants to try something different.

4 Q. How does alternate purchasing relate to Philip Morris USA's primary
5 objective of defending its market share?

6 A. Alternate purchasing is often the first step in the process of brand switching. In
7 other words, most adult smokers only switch brands after trying a brand other than their
8 regular brand. Obviously, the more times a Marlboro smoker purchases competitive
9 brands, like Winston, Newport or a discount brand, the more likely it is that the Marlboro
10 smoker might ultimately switch to one of those competitive brands. Therefore, in order
11 to maintain brand loyalty and defend our market share, we want to minimize the number
12 of times Philip Morris USA adult smokers make alternate purchases of competitive
13 brands.

14 Q. What does Philip Morris USA do to minimize alternate purchases by Philip
15 Morris USA adult smokers?

16 A. Understanding the reasons behind alternate purchasing is a first step. So, we rely
17 on market research to provide us with data about alternate purchasing rates and what
18 motivates alternate purchasing. Using what we learn from market research, we try to
19 design our marketing programs in a way that defends our current adult smokers against
20 competitive marketing activities that might influence them to make alternate purchases of
21 competitive brands.

22 Q. How does Philip Morris USA use its marketing programs to defend against
23 alternate purchasing of competitive brands?

1 A. The short answer is that we market to our own adult smokers. The longer answer
2 is that we do so in several different ways. First and foremost, we attempt to create brand
3 loyalty among Philip Morris USA adult smokers so that they will buy their brand 100
4 percent of the time instead of occasionally purchasing a competitive brand. We do this
5 by creating brand equity that our adult smokers come to appreciate and rely on. Then, for
6 those adult smokers who do make alternate purchases, we look at the reasons they are
7 purchasing competitive brands and try to offer them options for alternate purchases,
8 within the Philip Morris USA brand family, that they can choose instead of going to
9 competitive brands.

10 Q. What is brand equity?

11 A. Brand equity is all of the assets that are built up on behalf of a brand over time
12 that the consumer comes to recognize as the unique and distinguishing assets for that
13 brand. Brand equity (which we also refer to as the brand's value equation) is made up of
14 five elements – product, packaging, positioning, promotion and price point.

15 Q. Let's talk about each one of those in turn. How does the product contribute
16 to brand equity?

17 A. Let me use Marlboro as an example. Brand equity starts with the product, and
18 having a product that adult smokers like. For Marlboro, that means delivering a
19 consistently high quality, flavorful cigarette. A major part of having a product that adult
20 smokers want is also the lineup of brand extensions that are marketed under a single
21 brand name. It is essential to offer a sufficient variety of styles and versions of a brand to
22 satisfy a broad group of adult smokers with different preferences. Marlboro has a
23 significant share of adult smokers, but not all of those adult smokers have the same taste

1 and cigarette style preferences. Part of Marlboro's success can be attributed to its ability
2 to offer different Marlboro line extensions that adult smokers want. Finally, adult
3 smokers want a brand they can count on – a brand that tastes good, that is fresh, and that
4 is well made. And they want to know that their brand will deliver those qualities,
5 consistently, every time they buy it.

6 Q. How does packaging contribute to brand equity?

7 A. Packaging can be a very important factor. One of the reasons Marlboro gained
8 significant market share early on was its introduction in a new kind of packaging. When
9 Marlboro was repositioned in 1954 as the brand men smoke for flavor, it was introduced
10 in the Flip-Top box. Smokers liked this new box because it was easy to open and it was
11 sturdy enough to keep their cigarettes from being crushed. Today, packaging continues
12 to be important, not only from a functional standpoint, but also for what it communicates
13 about the brand. For example, packaging helps smokers to distinguish between different
14 brands and between the different line extensions offered within a single brand family.

15 Q. How does positioning contribute to brand equity?

16 A. Positioning describes the place that a brand occupies in adult smokers' minds.
17 Originally, Marlboro was repositioned as the brand that men smoked for flavor. Today,
18 the positioning is still focused on flavor, with the tag line: "Come to where the flavor is.
19 Come to Marlboro Country." Images of the cowboy and the American west, which were
20 initially designed to convey this notion of flavor, are still relevant and appealing to adult
21 smokers today. We also sometimes talk about positioning as including positioning at
22 retail. Smokers want to know that they can find their brand whenever they go into a store
23 to purchase cigarettes. If they have trouble finding stores that carry their brand, if the

1 brand is hard for them to find when they go into the store, or if the stores they visit are
2 routinely out of stock of their brand – those things can erode the equity of the brand in the
3 smoker's mind.

4 Q. Before we continue, let me ask you about one of the allegations in this case.
5 Is the Marlboro Country campaign targeted to underage people?

6 A. No.

7 Q. As part of your job duties at Philip Morris USA, have you become familiar
8 with the history of the marketing for the Marlboro brand?

9 A. Yes. In order to be effective in my marketing and market research positions, it
10 was necessary for me to learn the history of the company's most successful brand --
11 Marlboro.

12 Q. Has the Marlboro marketing campaign and strategy essentially remained the
13 same over the past 50 years?

14 A. Yes. The Marlboro marketing campaign has used western imagery as the center
15 of its advertising strategy for the past 50 years. Our consumer research has established
16 over the years that this imagery communicates themes that include independence,
17 masculinity and freedom. These themes are appealing to adult smokers across all age
18 groups.

19 Q. Please give the Court a brief history of the development of the Marlboro
20 marketing campaign over the past 50 years?

21 A. In the 1950s, Marlboro was an unfiltered cigarette that was marketed as a
22 women's brand. The brand's slogan was "Mild as May" because the taste was very mild.

1 It came with both an ivory tip and a red "beauty tip" that was designed to hide marks
2 from a woman's lipstick. In late 1954, Marlboro was repositioned.

3 Q. What does repositioning mean?

4 A. It describes the process of changing a product, or the marketing for that product,
5 or both, so that it is being presented to consumers in a new way.

6 Q. How was Marlboro repositioned in 1954?

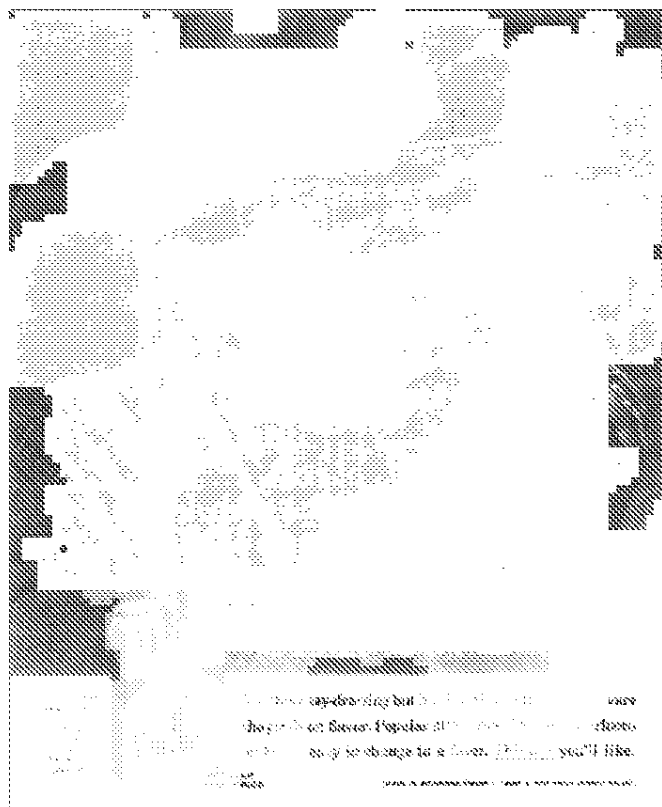
7 A. In the 1950s, the filter cigarette segment was beginning to grow. Winston had a
8 filtered cigarette that was really taking off. So, in an attempt to respond to what adult
9 smokers wanted -- Marlboro was repositioned from a women's cigarette to the filter
10 cigarette that men smoke for flavor.

11 Q. How did the marketing for Marlboro change with the repositioning?

12 A. Marlboro was repositioned with an ad that depicted a cowboy.

13 Q. Let me show you JD-040026. Is this an early Marlboro advertisement
14 showing the cowboy?

15 A. Yes, it is.



1

2 Q. Please continue with your explanation of the development of the Marlboro
3 campaign.

4 A. This first cowboy ad ran for a short period of time. It was followed by a series of
5 ads showing strong men smoking the cigarettes. We wanted to get adult male smokers to
6 try this new filter cigarette, and a predominant feeling among smokers at the time was
7 that filter cigarettes lacked flavor. So the idea was to show strong men who liked the
8 flavor of Marlboro.

9 Q. Was the repositioning of Marlboro successful?

10 A. Yes, it was.

11 Q. Following the repositioning, how well did Marlboro compete with other filter
12 cigarettes?

1 A. Marlboro was an overnight success, and it was gaining on the leading filter brand,
2 Winston. But Winston was doing just as well as Marlboro, so we wanted to do
3 something to capture the essence of the Marlboro brand in a way that adult smokers could
4 relate to. The hope was that if adult smokers could identify with the brand, the brand
5 could gain an even larger share of the market from Winston.

6 Q. What did you do to try to capture the essence of the Marlboro brand?

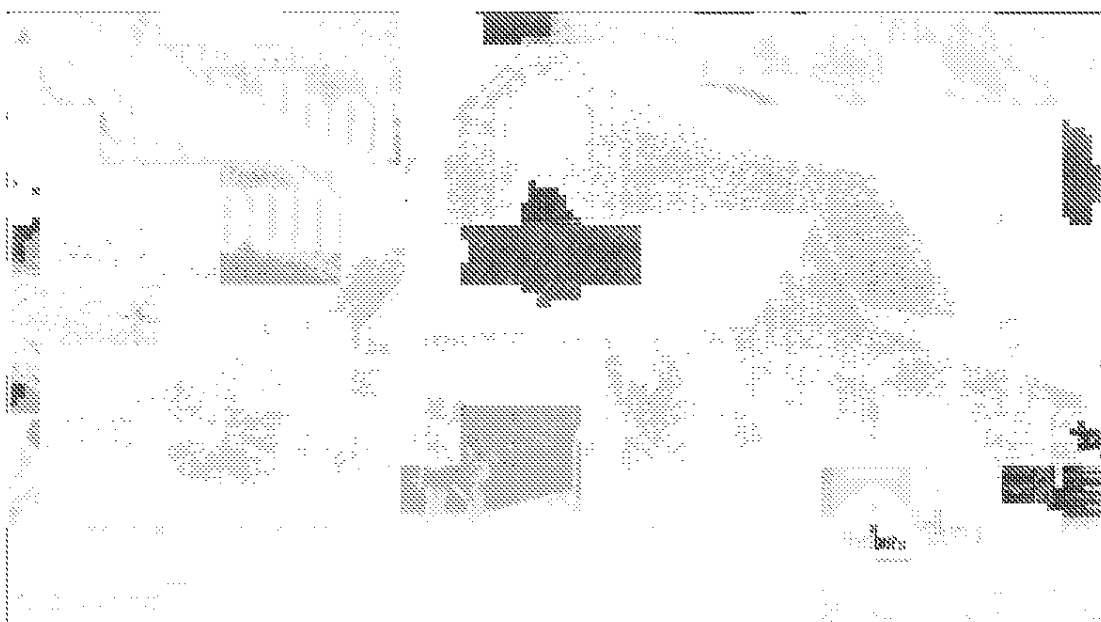
7 A. The company, along with its advertising agency, Leo Burnett, developed a
8 marketing campaign that is, for the most part, what we know today as the Marlboro
9 Country campaign. Initially, there were several very masculine looking Marlboro men,
10 including the cowboy. The campaign was then changed in an effort to make it clear that
11 Marlboro was available around the country, now using only the cowboy in the ads but
12 showing him in a variety of cities. The message was that wherever men smoke for flavor,
13 you will find Marlboro Country. Eventually, the decision was made to show the
14 Marlboro Man – the cowboy – living and working in the American West. The Marlboro
15 Country campaign that we know today was launched in 1964, and it has been the
16 campaign that has supported the brand to the present.
17

1 Q. I would like to show you some examples of Marlboro advertising over the
2 past 50 years. Let's take each decade, starting with the 1960's, and show the Court
3 the consistency of the Marlboro advertising campaign, with its focus on western
4 imagery. Let me show you JD-040026. Please explain what this exhibit is.
5 A. This is a Marlboro Country ad that ran in a magazine in 1966.



1 Q. Let me show you another page from JD-040026. Please explain what this
2 exhibit is.

3 A. This is a Marlboro Country ad that ran in a magazine in 1975.

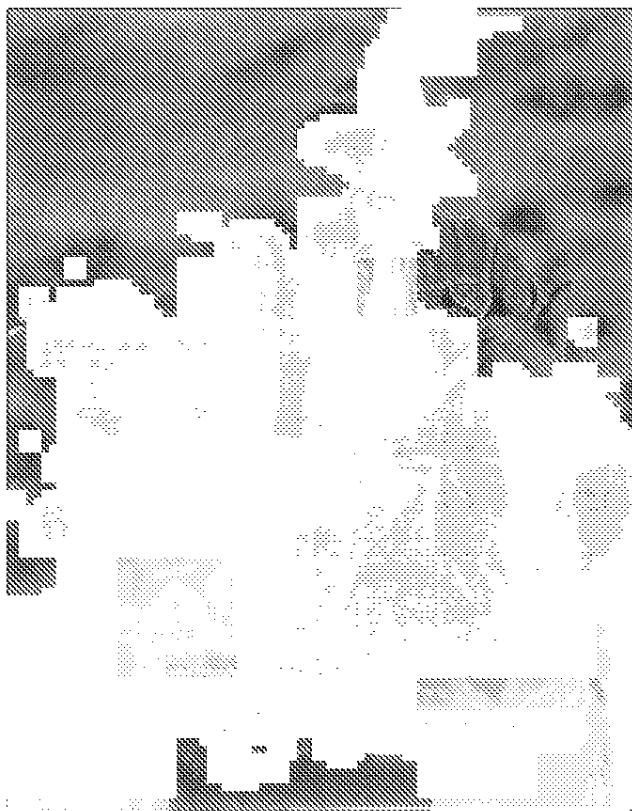


4

5

1 Q. Let me show you another page from JD-040026. Please explain what this
2 exhibit is.

3 A. This is a Marlboro Country ad that ran in a magazine in 1983.

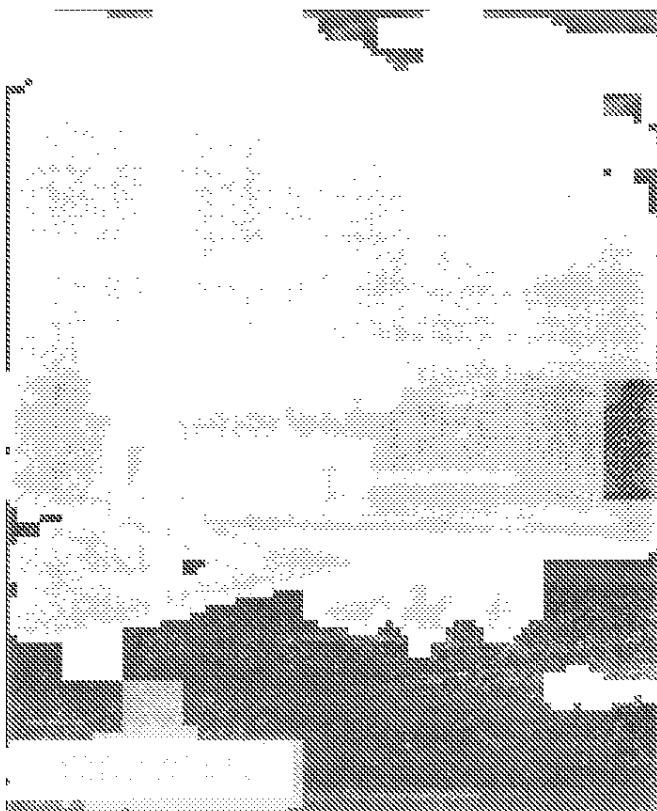


4

5

1 Q. Let me show you another page from JD-040026. Please explain what this
2 exhibit is.

3 A. This is a Marlboro Country ad that ran in a magazine in 1994.



4

5

1 Q. Let me show you US Ex. 76799. Please explain what this exhibit is.

2 A. This is a Marlboro Country ad that ran in a magazine in 2000.



3
4 Q. In recent years, has Philip Morris USA made substantial efforts to reduce the
5 visibility of Marlboro western imagery in its marketing communications?

6 A. Yes, we have. In fact, as of today the Marlboro western imagery has almost
7 disappeared from mass media. You can only see Marlboro western imagery in limited
8 Philip Morris USA marketing communications. For example, today you can see limited
9 western imagery at retail. You can also see western imagery in materials sent to our adult
10 smokers registered on our Adult Smoker Database.

- 1 Q. Let me show you JDEM-040029, which is a chart that I used during my
2 opening statement. Does this chart accurately represent the current status of
3 Marlboro western imagery in Philip Morris USA's marketing communications.
4 A. Yes, it does.

Philip Morris Current Marketing Practices		
Marlboro Mar and Western Imagery Virtually Eliminated		
	VISIBILITY	
	1998	2004
PRINT/MEDIA		
Magazines	YES	NO
Newspapers	YES	NO
OUTDOOR		
Billboards	YES	NO
Transit	YES	NO
Stadium	YES	NO
BRANDED NON TOBACCO ITEMS	YES	NO
SPONSORSHIP	YES	NO
DIRECT MAIL	YES	YES
POS/RETAIL	YES	Limited

5 JDEM-040029

- 6 Q. Why has Philip Morris USA reduced the visibility of Marlboro western
7 imagery as drastically, as reflected on JDEM-040029?

- 8 A. This has been done as part of Philip Morris USA's commitment to reduce the
9 overall profile of cigarette brand advertising.

- 10 Q. Consistent with this commitment, did Philip Morris USA recently use
11 Marlboro western imagery in a reduced-visibility fashion as part of a retail
12 promotion to celebrate Marlboro's 50th Anniversary?

1 A. Yes. We wanted to use the traditional Marlboro western imagery in a more
2 understated and less visible way than we would have in the past in celebrating a major
3 event in Marlboro's history. Therefore, as part of celebrating this 50th year anniversary
4 and to say thank you to Marlboro adult smokers, we created some special packaging. On
5 approximately two weeks' volume of Marlboro, adult smokers were able to purchase
6 cigarette packs wrapped in a special plastic printed with a small image of a western scene
7 and a thank you message. We intended the image to be visible to an adult smoker who
8 had purchased this anniversary pack.

9 Q. Returning to the brand value equation, how does the fourth element,
10 promotion, contribute to brand equity?

11 A. Promotion broadly refers to our efforts to market the brand. For Marlboro today,
12 that primarily means retail price and product promotions limited by law to legal age
13 smokers, direct mail promotions targeted to smokers 21 and older, and programs like the
14 Marlboro Ranch and Racing School that are primarily delivered through direct mail and
15 are also limited to smokers 21 or older.

16 Q. How does price point fit into the Marlboro brand's value equation?

17 A. Marlboro is a premium brand, and its pricing reflects that fact. But pricing is
18 intertwined with the other elements of the value equation. There is a reason why
19 Marlboro can be almost a 40-share brand despite its premium price – because it delivers
20 on the other elements of brand equity.

21 Q. What do you mean when you refer to all these elements as making up the
22 brand's value equation?

1 A. The price we can charge for a brand depends on how well we execute the other
2 four elements of the value equation. For a premium brand like Marlboro, if we have
3 created equity for the brand through its product, packaging, positioning and promotion,
4 then adult smokers are willing to pay a premium price for the brand.

5 Q. I want to return to our discussion of what Philip Morris USA does to defend
6 its market share. You mentioned that for those smokers who do make alternate
7 purchases, Philip Morris USA looks at the reasons they are purchasing competitive
8 brands and tries to offer them options for alternate purchases, within the Philip
9 Morris USA brand family, that they can choose instead. How does Philip Morris
10 USA do this?

11 A. I can give you a couple of examples. I mentioned earlier that we know from
12 market research that some adult smokers, and they are predominantly older smokers, who
13 call Marlboro their regular brand might feel they cannot afford to smoke Marlboro every
14 day. We hope that our Marlboro price promotions will be attractive to those adult
15 smokers who do not feel they can afford to purchase Marlboro at regular price every day.
16 Even though Marlboro under a price promotion will still be more expensive for those
17 adult smokers than a discount brand, we hope that the price promotion, combined with
18 the adult smoker's loyalty to the Marlboro brand, will provide enough incentive for that
19 smoker to purchase Marlboro, instead of another brand. We might also use product
20 promotions defensively to prevent Marlboro adult smokers from making alternate
21 purchases of a competitive brand that is also offering a promotion. In addition, using our
22 Adult Smoker Database, we might send these older adult smokers coupons that they may
23 redeem on their next purchase of Marlboro.

1 Q. You said that alternate purchasing is often the first step in the process of
2 brand switching. Is that the only reason Philip Morris USA is concerned about
3 alternate purchasing of competitive brands?

4 A. It is a significant reason, but it is not the only reason. We are also concerned
5 about the alternate purchases themselves. Even if the Marlboro adult smoker never
6 switches, we want to minimize the number of times he makes alternate purchases of a
7 competitive brand. The alternate purchases of competitive brands can also add up to
8 meaningful losses in market share.

9 Q. What does Philip Morris USA do to grow market share at the expense of its
10 competitors?

11 A. In addition to maintaining the brand loyalty of our current adult smokers, we
12 focus on encouraging switching and alternate purchasing by competitive brand adult
13 smokers.

14 Q. How does switching relate to Philip Morris USA's objective of growing
15 market share at the expense of its competitors?

16 A. We want adult smokers of competitive brands to switch to one of our brands as
17 their regular brand. For example, if an adult smoker has chosen Newport or Winston as
18 his regular brand, our ultimate goal is for him to switch to Marlboro as his regular brand.

19 Q. How does alternate purchasing relate to Philip Morris USA's objective of
20 growing market share at the expense of competitors?

21 A. Remember, I said that alternate purchasing is often the first step in the process of
22 brand switching and that most adult smokers only switch brands after trying a brand other
23 than their regular brand. In this case, the more times we can persuade adult smokers of

1 Newport and Winston, for example, to make alternate purchases of Marlboro, the more
2 likely it is that those Newport and Winston adult smokers might ultimately switch to
3 Marlboro. Therefore, in order to grow our market share, we want to increase the number
4 of times competitive brand adult smokers purchase Philip Morris USA brands on an
5 alternate basis.

6 Q. What does Philip Morris USA do to maximize alternate purchases of Philip
7 Morris USA brands by competitive brand adult smokers?

8 A. Once again, using market research data to understand the reasons behind alternate
9 purchasing is important. We also conduct market research to understand what
10 competitive adult smokers like or dislike about our brands and our marketing programs.
11 Informed in this way, we use our marketing programs to target competitive adult
12 smokers. Marketing to competitive smokers is certainly harder than marketing to our
13 own smokers, because many competitive smokers are loyal to their brands. One way to
14 attract competitive adult smokers is to introduce entries into our brand lineup that will
15 appeal to those smokers. We create awareness of those line extensions by using product
16 promotions at retail and by sending direct mail to competitive adult smokers on our Adult
17 Smoker Database.

18 Q. Is Philip Morris USA only focused on alternate purchasing of Philip Morris
19 USA brands by competitive adult smokers because you want those smokers to
20 switch to Philip Morris USA brands?

21 A. No. Certainly we want competitive adult smokers who make alternate purchases
22 of Philip Morris USA brands to switch to our brands. But here again, even if many of

1 those competitive smokers never switch, the alternate purchases they make of Philip
2 Morris USA brands can also add up to meaningful gains in market share.

3 VI. PHILIP MORRIS USA'S MARKETING OBJECTIVES JUSTIFY LARGE
4 MARKETING EXPENDITURES

5 Q. Are you generally aware that the Government contends that Philip Morris
6 USA's marketing expenditures are not justified by the goal of brand switching,
7 because the percentage of switchers in the marketplace is so small?

8 A. Yes, I am generally aware of that.

9 Q. Do you agree or disagree with this allegation?

10 A. I disagree.

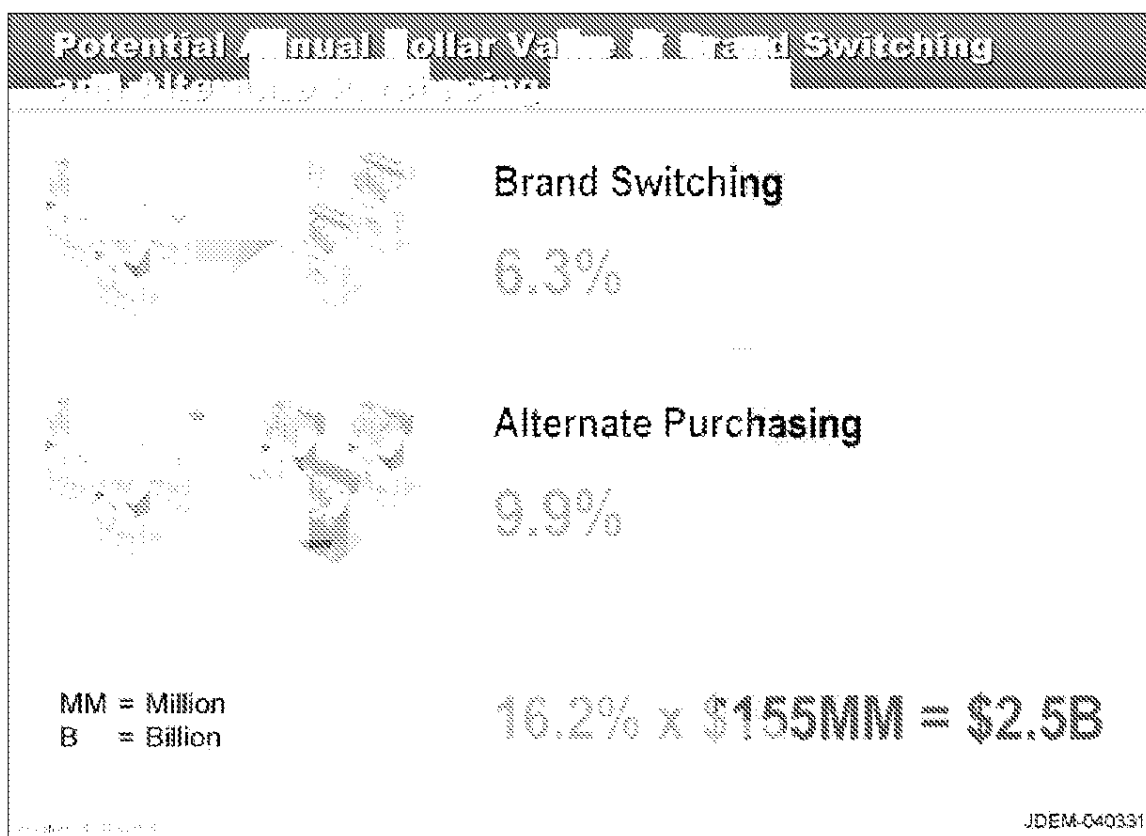
11 Q. Please explain why you disagree.

12 A. I disagree for three reasons. First, as I explained earlier, Philip Morris USA
13 focuses on both brand switching and alternate purchasing. Alternate purchasing is
14 important both because it is the first step toward switching and because the alternate
15 purchases themselves add up to significant market share. Second, as I explained earlier,
16 because Philip Morris USA has such a large overall market share, we benefit from low
17 switching rates. Third, even low switching and alternate purchasing rates represents
18 significant industry volume. For example, based on the CASTS data, approximately 16
19 percent of total industry volume for 2002 was purchased by adult smokers who had either
20 switched brands or bought a brand other than their regular brand at some point during the
21 past year. This represents approximately \$2.5 billion in potential income.

22 Q. Have you helped to prepare a demonstrative to illustrate your third point?

23 JDEM-040331.

1 A. Yes.



3 Q. What does this demonstrative show?

4 A. It sets forth the potential dollar value of market share that was at risk in 2002 due
5 to brand switching and alternate purchasing, and the total potential dollar value of that
6 market share.

7 VII. PHILIP MORRIS USA HAS BEEN SUCCESSFUL WITHOUT
8 TARGETING NONSMOKERS

9 Q. What is your response to the Government's allegation that Philip Morris
10 USA has to market to nonsmokers in order to be successful in the marketplace?

11 A. First, let me emphasize one point. Philip Morris USA does not market to
12 nonsmokers. We market our cigarette brands to adult smokers. All of our market

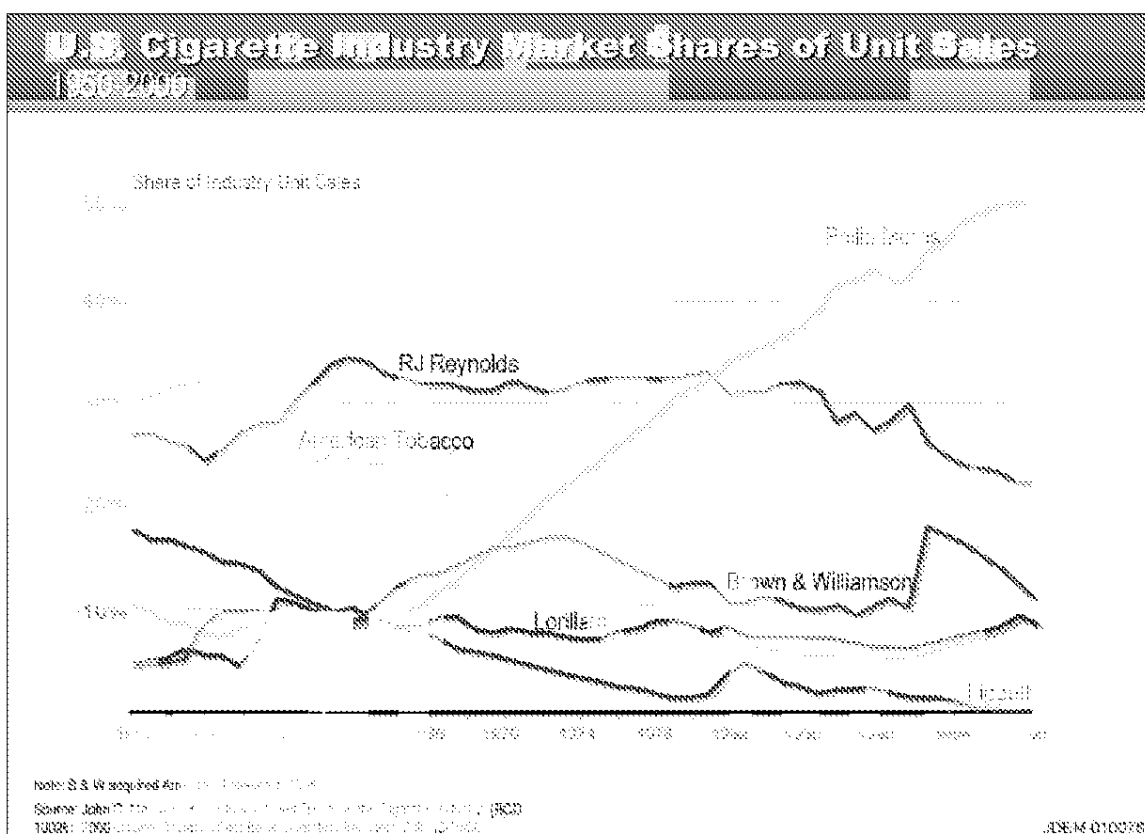
1 tracking and research, such as CASTS; marketing infrastructure, such as the Adult
2 Smoker Database; and marketing vehicles, such as the Marlboro catalog programs, are set
3 up to market our cigarette brands only to adult smokers. In addition, Philip Morris USA
4 has not needed and does not need to market to non-smokers in order to be financially
5 successful. The reality is that the cigarette market has been declining at an average rate of
6 1-2 percent annually since around 1982. However, Philip Morris USA has done very
7 well notwithstanding two and a half decades of industry decline by doing two things:
8 gaining share of this shrinking market at the expense of our competitors while increasing
9 our overall profitability.

10 Q. You said that Philip Morris USA has done very well notwithstanding two
11 and a half decades of industry decline by gaining share at the expense of its
12 competitors while increasing its overall profitability. How has its ability to gain
13 market share affected the success of Philip Morris USA since the industry began to
14 decline in the early 1980s?

15 A. Dramatically. In 1982, when the industry began the steady decline that continues
16 to this day, Philip Morris USA had approximately 33 percent share of the overall market.
17 Largely due to the growth of the Marlboro brand, Philip Morris USA's retail market share
18 as reported by IRI-Capstone is approximately 50 percent today.

19 Q. Let me show you JDEM-010076 which has been previously used in this case.
20 Does this demonstrative show changes in the market share of Philip Morris USA
21 and other major cigarette manufacturers from 1950 until 2000?

22 A. Yes.



Q. What is significant about the shifts in market share shown in this demonstrative?

A. Quite simply, Philip Morris USA gained market share at the expense of its competitors. As our market share grew, most of our competitors' market share shrank.

Q. You also said that Philip Morris USA has increased its overall profitability. How has Philip Morris USA done this?

A. We have done this in several ways. We have focused our marketing dollars on our best brands, mainly brands that allow us to carry premium pricing. We have continued to stress the premium portion of our portfolio, where our profit margins are higher. In addition, we continue to invest some of our profits back into our business, which in turn brings our costs down and makes us more profitable.

1 VIII. PHILIP MORRIS USA'S DOCUMENTS CONTRADICT THE
2 GOVERNMENT'S THEORIES ABOUT THE WAY PHILIP MORRIS USA
3 CONDUCTS ITS BUSINESS

4 A. PHILIP MORRIS USA'S MARKETING PLANNING DOCUMENTS

5 Q. Are there documents that set forth Philip Morris USA's strategies for
6 marketing its cigarette brands?

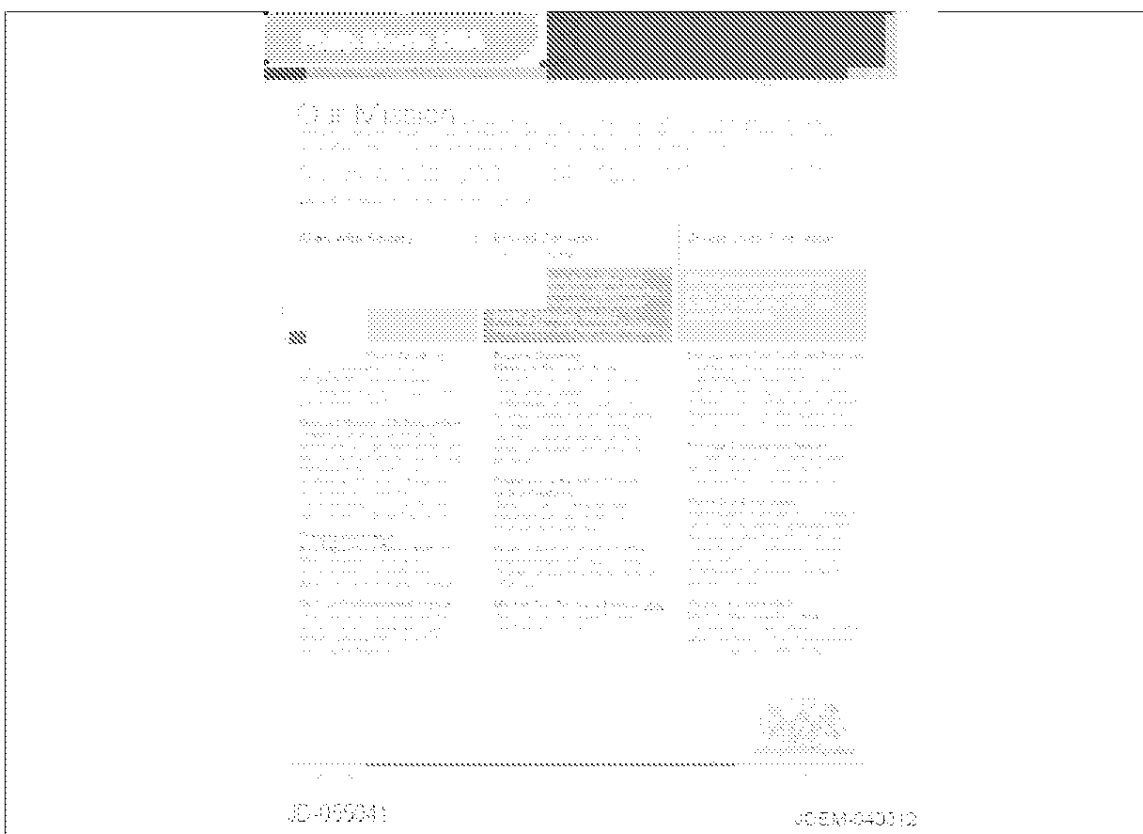
7 A. Yes. There are several different kinds of documents that we rely on in setting our
8 marketing strategies.

9 Q. Can you provide some examples?

10 A. Yes. The first would be our Mission and Values.

11 Q. Let me show you JDEM-040312. Is this the current Philip Morris USA
12 Mission Statement?

13 A. Yes.



Q. How does the Mission guide the development of your marketing strategies?

A. As the Mission states, "Our goal is to be the most responsible, effective and respected developer, manufacturer and marketer of consumer products, especially products intended for adults. Our core business is manufacturing and marketing the best quality tobacco products to adults who use them." We strive to exceed consumer expectations by, among other things, responsibly marketing our brands to adult smokers. These concepts are made clear in the company's Mission and Values Statement and guide everything that we do.

Q. Are there other documents that set forth Philip Morris USA's marketing strategies?

1 A. Yes. The Marketing Department participates in a company-wide planning
2 process called Game Plan. Through that process certain marketing initiatives are
3 developed and included in the company-wide planning for the year. Those initiatives are
4 identified, tracked, resourced and managed throughout the year at the highest levels in the
5 company. There are documents reflecting that process. In addition, one of the basic
6 planning documents the Marketing Department has used historically and still uses today
7 is called a Brand Plan. The Marketing Department will also create specific planning
8 documents for things like brand promotions or events or direct mail programs. In the
9 past, we have also used Media Plans reflecting our strategies for advertising in
10 newspapers and magazines.

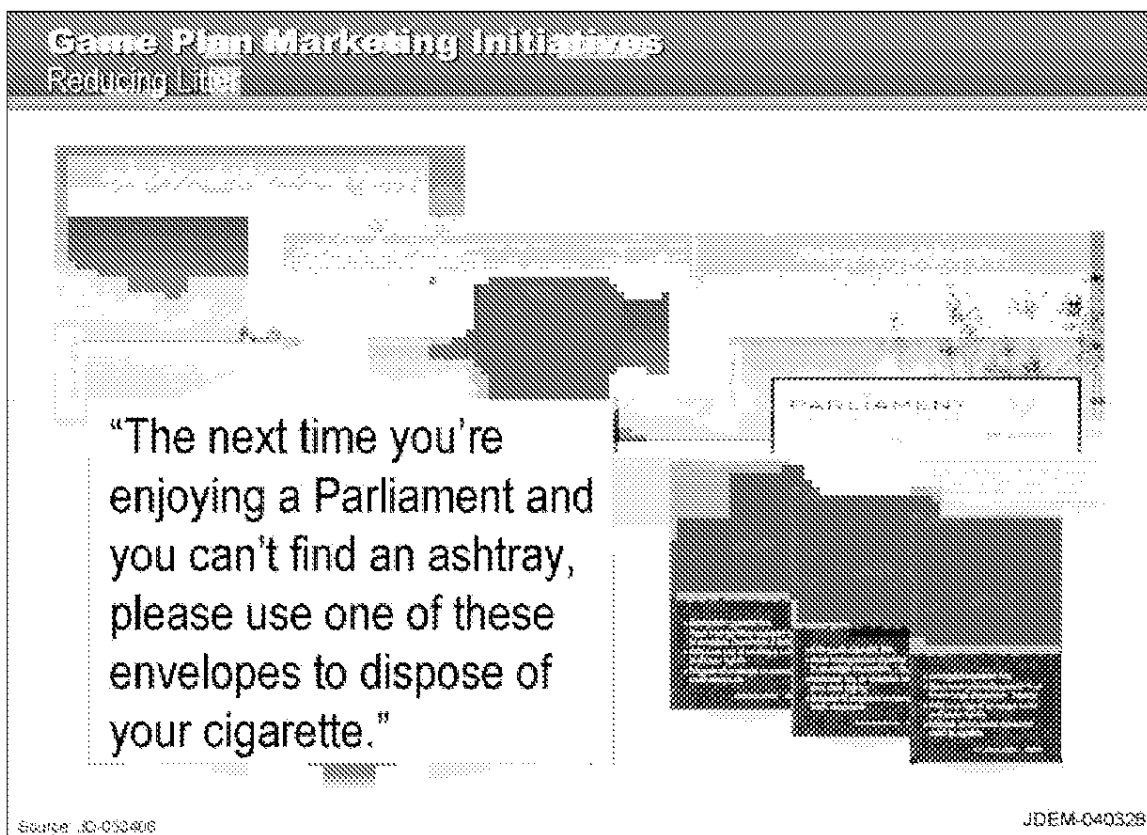
11 Q. There are literally thousands of marketing documents, and we do not have
12 time to examine all of them. I would like to focus your attention on a few examples.
13 Let me show you JD-050275. Is this an example of a document that shows progress
14 against some of the major initiatives that were developed during the Game Plan
15 process?

16 A. Yes. This document is the June 2003 State of the Business presentation given by
17 Mike Szymanczyk and me to our employees. Beginning on the page ending 4464, it lists
18 some of the major marketing initiatives that were identified in the Game Plan process.
19 For example, on page 4466, it describes the progress behind the launch of a Marlboro line
20 extension launch – Marlboro Blend No. 27.

21 Q. Was this document created in the regular course of Philip Morris USA's
22 business?

23 A. Yes.

- 1 Q. Let me show you JDEM-040328. Does this reflect another initiative?
- 2 A. Yes, this is a Parliament direct mail piece which illustrates some of our efforts to
- 3 reduce litter.



- 4 Source: JD-030406 JDEM-040328
- 5 Q. Let me now show you JD-046184. Is this an another example of one of the
- 6 types of documents you listed above?
- 7 A. Yes. It is the 1996 Parliament Media Plan, prepared by Philip Morris USA.
- 8 Q. What is a Media Plan?
- 9 A. It is a document setting forth our objectives, strategies and tactics for placing
- 10 advertising in select media vehicles, such as print or billboards.
- 11 Q. What is the purpose of a Media Plan?

1 A. Its purpose is to outline the recommendations and sometimes the final plans for
2 media selection and placement strategies for a particular brand that year.

3 Q. Does the Media Plan indicate the target audience for the advertising for
4 Parliament?

5 A. Yes. If you turn to the page bearing Bates Stamp number ending in 4397, you see
6 that the target audience is "Young Adult (LA-34) Smokers"

7 Q. Let me now show you JD-040786. Is this an another example of one of the
8 types of documents you listed above?

9 A. Yes. It is the 1990 Marlboro Brand Plan.

10 Q. What is a Brand Plan?

11 A. The Brand Plan is the overall marketing plan that is created for a brand each year
12 by the Marketing Department.

13 Q. What is the purpose of a Brand Plan?

14 A. Its purpose is to outline the recommendations and sometimes the final plans for
15 the brand for the year, documenting every aspect of the marketing program, including
16 goals, objectives, strategies and tactics. A Brand Plan is intended to cover the major
17 elements of marketing for the brand, whatever they might be. However, it would be a
18 mistake to think of the Brand Plan as a single, static document. The brand planning
19 process is dynamic, so for example there might be several evolutions of a Brand Plan for
20 Marlboro in a given year, if the competitive dynamics change.

21 Q. Is a Brand Plan prepared for each brand which receives marketing support?

22 A. Yes. A plan is written for each brand that receives marketing support. If a brand
23 does not receive marketing support, no plan is necessary.

1 Q. Who writes the Brand Plans?

2 A. Usually the brand manager who is responsible for running the brand, with
3 assistance from others in the brand group.

4 Q. How important are the Brand Plans at Philip Morris USA?

5 A. They are very important because they set forth the overall plan for the brand each
6 year. If you want to understand the marketing strategy for a particular brand, you need to
7 look at its Brand Plan.

8 Q. Does a Brand Plan have to be approved?

9 A. Yes. After the Brand Plan is drafted and vetted and revised among those in the
10 brand group, the process culminates in a presentation of the Brand Plan to senior
11 management for approval.

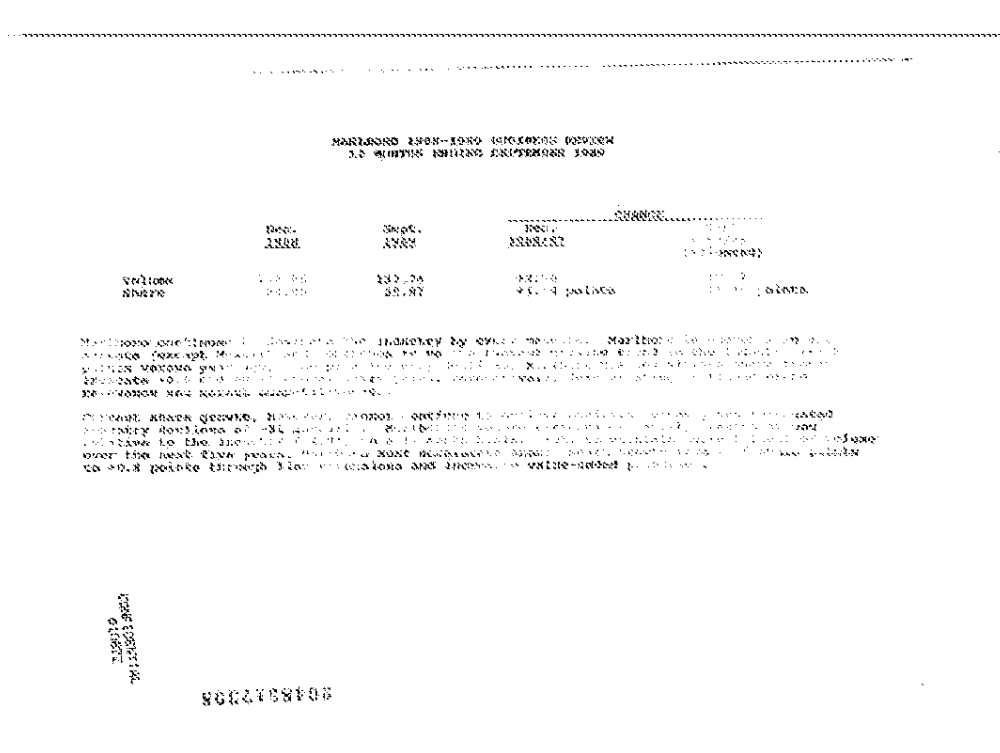
12 Q. What types of information does a Brand Plan contain?

13 A. It has varied over the years. However, it generally includes an evaluation of the
14 current situation facing the brand, including switching and alternate purchasing rates as
15 well as competitive threats to the brand. It also sets forth the target audience for
16 marketing efforts behind the brand. And it usually sets forth the objectives, strategies and
17 tactics for the brand for the coming year, including budgets and timelines.

18 Q. Please look at JD-040786 and turn to the page ending in 7398. What
19 information is reflected on that page?

20 A. This page begins the business analysis for 1988 and 1989, which sets the
21 foundation for potential market share and unit volume objectives for 1990. This analysis
22 shows that Marlboro's cigarette volume during the 12-month period ending September
23 1989 grew 0.2 percent. The Brand Plan states: "Current share growth, however, cannot

1 continue to deliver positive volume given forecasted industry declines of -3 %
 2 annually. . . . Yet, to maintain the current level of volume over the next five years,
 3 Marlboro must accelerate annual share growth from +0.6 share points to +0.8 points
 4 through line extensions and increased value-added promotion." This reflects one of the
 5 objectives I described earlier: gaining market share in a declining market at the expense
 6 of our competitors. It indicates that if Marlboro is to maintain its current level of volume
 7 in the declining market, it can only do so through increased market share gain.



8
 9 Q. Does that brand plan include information about the age groups Marlboro
 10 was targeting?
 11 A. Yes. On the page ending in 7391, it lists the primary target audience for
 12 Marlboro: "males (21-29)."

PROMOTION

The 1990 promotion plan for the Marlboro brand is designed to increase brand awareness and sales. The plan is based on the following objectives:

1. INCREASE AWARENESS

Marlboro's objective is to increase awareness of the brand among young adult men and women. This will be achieved through a combination of television, radio, and print advertising. The plan also includes a series of point-of-purchase displays and a series of direct mail pieces.

In 1990, Marlboro will launch a new series of advertisements on late of the plan. The plan also includes a series of point-of-purchase displays and a series of direct mail pieces.

The plan also includes a series of point-of-purchase displays and a series of direct mail pieces. The plan also includes a series of point-of-purchase displays and a series of direct mail pieces.

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2 Q. On the page ending in 7410, the brand plan discusses the 1990 promotion
3 plan objectives. What does the plan list?

4 A. The brand plan lists five objectives:

- 5 • Generate high trial and conversion among young adult men and women
- 6 • Increase alternate usage of competitive smokers
- 7 • Encourage continuity of purchase among current smokers
- 8 • Raise the level of promotion visibility
- 9 • Develop and field more unique, never been seen before incentives and
10 promotions.

11 Q. What is meant by the first three objectives?

1 A. The first three objectives deal with brand loyalty among existing smokers, which I
2 have discussed previously.

3 Q. What do the terms "trial" and "conversion" mean?

4 A. Trial refers to the trial of Philip Morris USA brands by smokers of competitive
5 brands. Conversion can only happen after trial. It refers to brand switching.

6 Q. What is meant by the fourth and fifth objectives?

7 A. The fourth and fifth objectives refer to the promotion element of our brand value
8 equation, which I described earlier.

9 Q. How many people are involved in implementing the strategies set forth in a
10 typical Brand Plan?

11 A. Thousands. There are thousands of people involved in marketing our brands,
12 including the people in the brand group; our advertising agencies; the people involved in
13 executing particular elements of the plan, like bar nights and direct mail; employees in
14 other areas of the company, such as finance, legal, research and development,
15 manufacturing and the sales force; and any other people involved in the various elements
16 of implementation.

17 Q. Have you ever seen any Philip Morris USA Brand Plan that includes a goal
18 or strategy to market its cigarette brands to nonsmokers?

19 A. No.

20 Q. Have you ever seen any other Philip Morris USA marketing planning
21 documents that include a goal or strategy to market its cigarette brands to
22 nonsmokers?

23 A. No.

1 Q. If that was the goal or strategy for a brand, would it need to be set forth
2 somewhere in the Brand Plan?

3 A. Yes.

4 Q. Have you ever seen any Philip Morris USA Brand Plan that includes a goal
5 or strategy to market its cigarette brands to minors?

6 A. No.

7 Q. Have you ever seen any other Philip Morris USA marketing planning
8 documents that include a goal or strategy to market its cigarette brands to minors?

9 A. No.

10 Q. If that was the goal or strategy for a brand, would it need to be set forth
11 somewhere in the Brand Plan?

12 A. Yes.

13 B. PHILIP MORRIS USA'S MARKET RESEARCH DOCUMENTS

14 Q. We have already discussed market research at length, Mr. Beran, I would
15 like now to focus on one additional issue regarding two types of market research
16 documents. First, let me show you JD-046265. Please describe this document?

17 A. It is a Consumer Tracking Study report for the year ending June, 1995 utilizing
18 information from CASTS.

19 Q. Was it prepared in 1995 in the regular course of Philip Morris USA's
20 business?

21 A. Yes.

22 Q. After reviewing that document, does the document contain any data relating
23 to nonsmokers or people under the legal age to purchase cigarettes?

1 A. No.

2 Q. Let's turn to the second type of market research document on which I would
3 like to focus at this time. Please review JD-046268 and JD-050788? What are these
4 documents?

5 A. They are focus group reports. The first is dated December 1996 and concerns
6 Marlboro print ads. The second is dated September 2002 and concerns potential
7 continuity items under review for the 2003 Marlboro catalog.

8 Q. What is a focus group report?

9 A. It is a report written by a third party market research firm summarizing the results
10 of conversations with adult smokers who participated in a research study on a particular
11 marketing topic area.

12 Q. Why are these documents important?

13 A. These reports give us insight into what adult smokers think about our various
14 programs, specifically, in these focus groups, Marlboro print ads and our Marlboro
15 continuity program.

16 Q. Do these documents contain any information relating to nonsmokers or
17 people under the legal age to purchase cigarettes?

18 A. No.

19 C. PHILIP MORRIS USA'S BUSINESS PLANNING DOCUMENTS

20 Q. What is the Philip Morris USA Five Year Plan?

21 A. The Five Year Plan, which is drafted annually, sets forth the business plan for the
22 company looking forward five years.

23 Q. What types of information can be found in Five Year Plans?

1 A. Five Year Plans typically include income projections, cash flow projections,
2 discussion of future industry volume, the competitive framework and Philip Morris USA
3 strategies.

4 Q. Have you seen any Philip Morris USA Five Year Plans that includes a
5 strategy to increase the overall size of the cigarette market?

6 A. No. I have never seen a Five Year Plan that includes such a strategy. Since I
7 have been involved with the planning process, Philip Morris USA has never had a
8 strategy to increase the overall size of the cigarette industry. On the contrary, our
9 business planning is based on the assumption that the market will continue to decline.

10 Q. Let me show you JD-050153. What is this document?

11 A. It is the Philip Morris USA 2002-2006 Five Year Plan.

12 Q. Does this document reflect the assumption that the cigarette market is in
13 decline?

14 A. Yes. It also reflects Philip Morris USA's response to the shrinking cigarette
15 market – to try to gain greater market share at the expense of our competitors – not to
16 grow the market itself.

17 Q. If Philip Morris USA was trying to grow the cigarette market, would you
18 expect to see that goal set forth somewhere in its Five Year Plans?

19 A. Absolutely. If Philip Morris USA was trying to grow the cigarette market, our
20 business planning documents would have to reflect that strategy.

21 Q. What would you expect to see?

22 A. I would expect to see a Five Year Plan showing a current decline in the market,
23 but forecasting a sustained increase in industry volume in subsequent years. I would

1 expect to see strategies for how to increase industry volume, such as sending direct mail
2 to adult nonsmokers to try to convince them to smoke.

3 Q. When the Five Year Plans include goals for increasing share and volume,
4 what does that refer to?

5 A. You will see Five Year Plans that include that goal after the market began its
6 decline in 1982. When the Plans say increase share and volume, what that meant was
7 that we wanted to grow share at a rate that was greater than the decline in overall industry
8 volume. Stated another way, we would build into our Five Year Plans assumptions that
9 had us taking more volume from our competitors than we were losing due to the overall
10 industry decline rate.

11 D. DOCUMENTS CONTAINING DATA ON PERSONS UNDER THE AGE
12 OF 18 DO NOT DEMONSTRATE THAT PHILIP MORRIS USA WAS
13 TARGETING ITS MARKETING TO MINORS

14 Q. Have you heard of a man named Myron Johnston?

15 A. Yes, I knew Mr. Johnston.

16 Q. What was Mr. Johnston's role at Philip Morris USA?

17 A. Mr. Johnston worked in the Philip Morris USA research center in Richmond,
18 Virginia, where he analyzed various data. As I recall, he looked at things like smoking
19 incidence and other economic factors. Mr. Johnston worked with a small group of
20 researchers who were given the latitude to think and to write about a variety of subjects
21 that were of interest to them.

22 Q. Was Mr. Johnston someone who helped set company policy at Philip Morris
23 USA?

1 A. No. When he retired, he was a grade level 13 employee. At that grade level, Mr.
2 Johnston would not have been in a position to set company policy.

3 Q. Did Mr. Johnston ever work in the Marketing Department at Philip Morris
4 USA?

5 A. No.

6 Q. Have you ever used any information provided to you by Mr. Johnston?

7 A. Yes. There are two occasions I can recall. When I worked in Business Planning
8 developing the Five-Year Plans, my department included in plans for two years, 1988 and
9 1989, a reference to the University of Michigan survey data that Mr. Johnston had
10 distributed. My department included the data within the plans as further evidence that the
11 industry would continue to decline.

12 Q. Did you use this University of Michigan data to develop any strategy or plan
13 to increase the overall size of the industry?

14 A. No.

15 Q. Are you aware that anyone in the marketing department ever used any data
16 supplied by Mr. Johnston to develop any plan for marketing to people under the
17 legal smoking age?

18 A. No.

19 Q. The government has alleged that Myron Johnston's documents discussing
20 minors show that Philip Morris USA was marketing to people under 18. How do
21 you respond to that?

1 A. I know what our marketing practices were when I joined business planning in
2 1987, and I can say without hesitation that Philip Morris USA was not marketing to
3 anyone under the age of 18.

4 IX. THE MARLBORO BRAND

5 Q. Are you generally aware that the Government alleges that Philip Morris
6 USA markets its Marlboro brand to underage people?

7 A. Yes.

8 Q. I am going to direct your attention to the testimony of one of the
9 Government's expert witnesses, Anthony Biglan. Dr. Biglan testified as follows:
10 "[T]hrough its marketing of Marlboro, Philip Morris associates the brand with the
11 themes and images of masculinity and independence which make the brand
12 appealing to adolescents. In addition, Philip Morris USA marketing of Marlboro
13 communicates that the brand is very popular and thereby influences adolescents to
14 believe that smoking Marlboro will enhance their acceptance by their peer group
15 because they are smoking the leading brand. In addition to these primary themes,
16 Philip Morris also associates the Marlboro brand with images of excitement and
17 adventure and sometimes associates the Marlboro brand with themes of relaxation.
18 . . . [A]l of these themes are important to adolescents." [A.Biglan, Written Direct
19 Testimony, 119:22-120:7.] Do you agree with this testimony?
20 A. No. I disagree. First, as I discussed previously, our positioning for the Marlboro
21 brand clearly targets and appeals to adult smokers. In addition, over the years I have seen
22 research which suggests that Marlboro advertising themes have a higher appeal among
23 adult smokers over the age of 30 than with adult smokers 21-29.

1 Q. Let me show you US Ex. 24,685, entitled "Marlboro Marketing Mix Monitor
2 – 1999." What does this document show concerning adult smokers' reaction to
3 Marlboro's advertising themes?

4 A. It shows that our advertising campaign seems to resonate more strongly with older
5 smokers ages 30-45. For example, on page 32 of the exhibit, it shows that the themes of
6 adventure, living life to the fullest and masculinity, all appeal more to smokers 30-45
7 than to smokers 21-29. On page 27, it states, [m]ainline advertising seems to
8 communicate more strongly to older Marlboro smokers." On page 28, it states "[o]lder
9 smokers not only like Marlboro advertising more than young adult smokers, but view it
10 as an example of the brand's creative efforts."

11 Q. Over the past seven years, has Marlboro's market share of adult smokers
12 grown?

13 A. Yes.

14 Q. Let me show you JD-053362. What is this document?

15 A. It is the Continuous Adult Smoker Tracking Study report dated December 2002.

16 Q. Does this document contain information regarding the age demographics of
17 Marlboro's share growth?

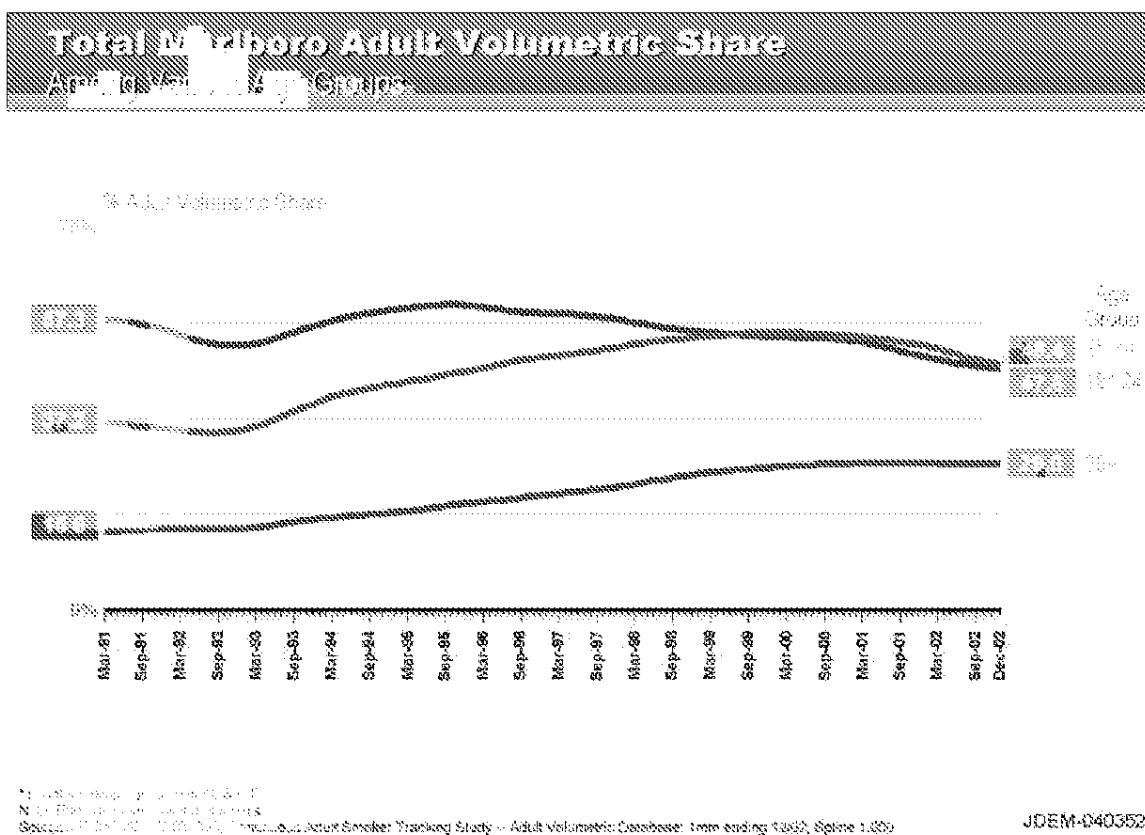
18 A. Yes. On page 22, the report shows Marlboro's share between 1988 and 2002
19 among various age groups of adult smokers.

20 Q. Let me show you JDEM-040352. What is this exhibit?

21 A. It is a demonstrative exhibit based on the information found on page 22 JD-
22 053362.

23 Q. What does this information show?

- 1 A. It shows that all of Marlboro's share growth since late 1995 has come from adult
2 smokers who are age 25 and older.



- 3
4 Q. In which age group of adult smokers does Marlboro have its greatest market
5 share?

- 6 A. Marlboro has its largest share among adult smokers age 25 to 34. In fact, this
7 report shows that Marlboro's share among smokers legal age to 24 has been declining
8 since 1995.

- 9 Q. Do the market share data we have just discussed support the allegations
10 made by the Government?

- 11 A. No.

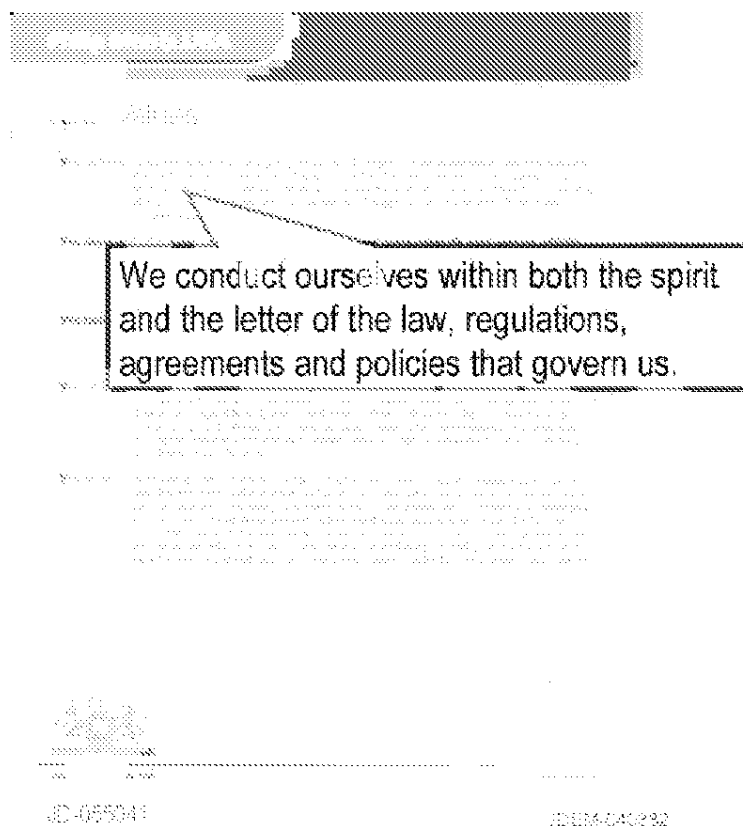
1 X. MARKETING COMPLIANCE

2 Q. Does Philip Morris USA have any policies and procedures in place that deal
3 with marketing compliance?

4 A. Yes. First, one of our Core Values is to "conduct ourselves within both the spirit
5 and the letter of the law, regulations, agreements and policies."

6 Q. Is that Core Value highlighted on JDEM-040382?

7 A. Yes.



8

9 Q. What procedures do you have in place to ensure that Philip Morris USA's
10 marketing practices are in accordance with that Core Value?

11 A. We have a number of procedures in place to ensure that our marketing activities
12 are conducted in compliance with the laws and standards that govern our business.

1 Q. What are some of the laws and standards that govern Philip Morris USA's
2 marketing of cigarettes?

3 A. They fall into four main areas. We are bound by federal and state laws and
4 regulations that govern our marketing programs. For example, our brand advertising is
5 subject to Federal Cigarette Labeling and Advertising Act. In addition to those laws and
6 regulations, we are governed by the industry's Voluntary Cigarette Advertising Code.
7 We must also comply with restrictions on our marketing set forth in the MSA. Finally,
8 we have instituted a number of corporate policies over the years that guide our marketing.

9 A. VOLUNTARY CIGARETTE ADVERTISING CODE

10 Q. At this time, I would like to ask you about one of the areas you mentioned.
11 What is the Voluntary Cigarette Advertising Code?

12 A. In 1964, the industry adopted a voluntary Cigarette Advertising Code, setting
13 forth standards for cigarette brand advertising. The original 1964 Code contained
14 restrictions designed to prevent the unintended appeal of cigarette brand advertising to
15 youth.

16 Q. What is JD-047672?

17 A. This is a copy of the 1964 Voluntary Advertising Code.

18 Q. Was the 1964 Code revised at some point?

19 A. Yes. The Code was revised in 1990.

20 Q. What were some of the restrictions on marketing practices in the 1990
21 amendments to the Ad Code?

22 A. The 1990 version of the Code added restrictions to address marketing practices
23 that came into use after the issuance of the 1964 Code. For example, the 1990 Ad Code

1 prohibited billboards located within 500 feet of any school and prohibited paid movie
2 product placements. In addition, the 1990 Code contained a number of provisions
3 designed to address the relatively new practice of distributing branded promotional items.
4 In this regard, the Code prohibited mail distribution of branded incentive items without
5 verification that the addressee was a smoker 21 years or older who wished to receive such
6 items, and prohibited any other distribution of nontobacco incentive items to persons
7 under 21 years of age with one exception: such incentive items could be distributed to
8 legal age smokers at retail with the purchase of a package or carton of cigarettes.

9 Q. What is US Ex. 25,272?

10 A. This is a copy of the 1990 Advertising Code.

11 Q. Did the 1990 amended Ad Code contain a restriction on marketing to legal
12 age smokers between the ages of 18 and 20?

13 A. No. The 1990 Code does not prohibit retail marketing practices directed to legal
14 age smokers under the age of 21. The preamble to the Code makes it clear that the
15 cigarette manufacturers supported the enforcement of state laws prohibiting the sale of
16 cigarettes to persons under 18 years of age and were only marketing their cigarette brands
17 to adult smokers, that is smokers 18 and older.

18 Q. What exactly does the Code say in this regard?

19 A. The first paragraph of the Code says:

20 Cigarette smoking is an adult custom. Children should not
21 smoke. Laws prohibiting the sale of cigarettes to minors
22 should be strictly enforced. The cigarette manufacturers
23 advertise and promote their products only to adult smokers.
24 They support the enactment and enforcement of state laws
25 prohibiting the sale of cigarettes to persons under 18 years
26 of age.

1 Q. Are there other sections of the Code that speak to the issue of whether it
2 prohibited marketing to legal age smokers 18 through 20 years of age?

3 A. Yes. This is also seen in the section addressing the distribution of branded
4 incentive items. More specifically, while the Code prohibits the distribution of branded
5 incentive items though the mail to anyone under 21, it allows the distribution of branded
6 incentive items to legal age smokers at retail.

7 Q. Has Philip Morris USA taken steps to comply with the Code?

8 A. Yes. The Code restrictions are incorporated into various areas of our marketing
9 policies and practices. Overall, and particularly prior to the MSA, we designed our
10 marketing policies and practices to take into account and to comply with the standards
11 contained in the Advertising Code.

12 Q. Can you give some examples?

13 A. Yes. For example, our advertising compliance procedures include a review of
14 proposed advertising to make sure that the models are and appear to be over 25 years of
15 age, and that the content of the ads does not include themes or images prohibited by the
16 Code. These compliance procedures involve a review of proposed ads by our Brand
17 Group, by our outside advertising agencies and a legal review. And each level of review
18 is designed to ensure compliance with all applicable laws, regulations and policies,
19 including the Ad Code.

20 B. LEGAL REVIEW OF MARKETING COMMUNICATIONS

21 Q. You mentioned a legal review of marketing materials. What does that
22 entail?

1 A. Every one of our marketing communications must undergo legal review by our in-
2 house legal department. In addition, materials that are produced by outside advertising
3 agencies must also undergo legal review by their in-house lawyers.

4 Q. Why does Philip Morris USA require legal review for its marketing
5 communications?

6 A. In light of all of the laws and regulations governing our cigarette brand marketing,
7 it is essential that there be some legal checkpoint to help ensure that we are complying
8 with those obligations.

9 Q. What is JD-043328?

10 A. This is an example of training provided to members of the marketing department
11 on our compliance procedures.

12 XI. IMPACT OF THE MSA

13 A. MARKETING RESTRICTIONS IN THE MSA

14 Q. Does the MSA impose restrictions on how Philip Morris USA markets its
15 cigarette brands?

16 A. Yes. The MSA places extensive restrictions on cigarette brand marketing
17 practices. It prohibits the placement of cigarette advertising on billboards, in stadiums
18 and arenas, in shopping malls, and on buses, taxis and other transit locations. It restricts
19 the size of outdoor advertisements at retail locations. And it prohibits paid placement of
20 brand names in movies, television and other media. The MSA restricts the content of
21 cigarette brand marketing by prohibiting cartoon characters or illustrations that attribute
22 human characteristics or unnatural abilities to an animal, plant or object. It prohibits the
23 distribution of branded merchandise to consumers. It prohibits the distribution of free

1 samples of cigarettes except in adult only facilities. It limits us to a single Brand Name
2 Sponsorship. In addition, it contains an overall prohibition on youth targeting.

3 Q. What does the MSA say about targeting youths?

4 A. It says that the tobacco companies should take no action to target youth in
5 advertising, promotion or marketing cigarettes, or to initiate, maintain or increase the
6 incidence of youth smoking.

7 Q. Your current position includes supervision of the Government Affairs
8 Coordination Department, right?

9 A. Yes, that is right.

10 Q. Does the MSA impose any restrictions on lobbying?

11 A. Yes.

12 Q. Let me show you paragraph III(m) of the MSA, JD-045158. What subject is
13 addressed by this paragraph?

14 A. This paragraph imposes limitations on lobbying. It prohibits the company signing
15 the MSA from opposing legislation that is intended to reduce the incidence of youth
16 smoking.

17 Q. Does the MSA require Philip Morris USA to do something with its
18 documents?

19 A. Yes. The MSA requires that, through June 30, 2010, we make publicly available
20 on a website many documents we produce in litigation.

21 Q. What is your understanding of the purpose of the requirement that Philip
22 Morris USA post its documents on a website open to the public?

1 A. There have been allegations that the tobacco companies have hidden information.
2 This is an effort to ensure that the documents reflecting our business practices are
3 available to the public.

4 B. MSA COMPLIANCE

5 Q. What does Philip Morris USA do to make sure that it is complying with the
6 marketing provisions of the MSA?

7 A. One of the first things we had to do was to review our business practices that
8 would potentially be affected by the MSA. Although many were consistent with the
9 requirements of the MSA, others needed to be changed. We then instituted procedures
10 company-wide that make it clear to our employees and to the outside vendors we work
11 with that we are committed to what we call "gold standard" compliance with the MSA.
12 We provide training to make sure that our marketing and sales employees and outside
13 vendors know about the requirements of the MSA. We have created a new department at
14 Philip Morris USA that is responsible for compliance with a variety of laws and
15 regulations, as well as the MSA. In addition, within the Marketing Department we
16 appointed a Senior Director of Marketing Compliance. As a result, we have both senior
17 executives and employees whose primary responsibilities are to monitor our compliance
18 with the regulations we are required to follow, as well as the MSA. In addition, we are
19 regularly communicating with the state Attorneys General about specific issues of
20 compliance that might arise under the MSA.

21 Q. What kind of training did Philip Morris USA do with respect to the
22 marketing provisions of the MSA?

1 A. When the MSA first went into effect, we created comprehensive training
2 programs, including hypothetical scenarios and question/answer sessions, for the entire
3 Marketing Department and the entire Field Sales Force that services our retail accounts.
4 We prepared excerpts of MSA provisions that would affect employees most frequently,
5 and distributed them to each employee we trained. In addition, we trained outside
6 vendors that would be affected by the MSA, like our advertising agencies and the
7 companies who help run our promotional events. This training was required for all
8 employees whose job functions were at all affected by the MSA.

9 Q. Did this training expand to the rest of the company?

10 A. Yes. We took those training programs and incorporated them into the orientation
11 that all new employees receive.

12 Q. Let me show you exhibits marked JD-048672 and JD-048529. What are
13 these documents?

14 A. The first document, JD-048672, is a matrix prepared as part of our MSA
15 compliance activities summarizing open issues and activities that the company had to
16 undertake as we were implementing the MSA. The second document, JD-048529, is an
17 MSA compliance training presentation used to train senior management, including me.

18 Q. Were these documents prepared in the regular course of Philip Morris USA's
19 business?

20 A. Yes, they both were.

21 Q. Has the Marketing Department made any other additions to the training it
22 gives employees on compliance issues, including the MSA?

1 A. Yes. We have taken a number of additional steps. For example, we developed a
2 marketing training course called Links, which includes training on various legal,
3 regulatory and policy issues, including the MSA.

4 Q. Let me show you JD-052746 and JD-052747. What are these documents?

5 A. These are examples of documents used as part of the Links Training Program.

6 Q. You mentioned the appointment of a Senior Director of Marketing
7 Compliance. What is the role of that position?

8 A. As the name would suggest, that position focuses on making sure that our
9 marketing activities and programs are in compliance with all applicable standards,
10 including the MSA. While we expect everyone in the organization to be fully familiar
11 with and act in compliance with all applicable standards, the Marketing Compliance
12 Department has a training and supervisory role over compliance activities. Through this
13 process, all advertising, point of sale, direct mail, sponsorship, continuity and other
14 marketing materials are reviewed.

15 Q. What does "gold standard" compliance mean?

16 A. It means that compliance is a top priority and that we will comply with both the
17 letter and the spirit of the MSA. Particularly in the context of our marketing, we do not
18 only look at what the MSA explicitly requires or prohibits. We try to focus instead on the
19 reasons behind the specific provisions that govern our marketing and one of the main
20 goals of the MSA, which is to prevent youth smoking.

21 Q. Has Philip Morris USA maintained any record of the steps it has taken to
22 comply with the MSA?

1 A. Yes. We maintain files for the areas of the company that have undergone policy
2 or practice changes as a result of the MSA, and those files include documentation of the
3 actual steps that were taken to comply with the requirements of the MSA. For example,
4 we have extensive documentation of the removal of billboard ads, including pictures for
5 each location. In addition, we prepared MSA Compliance Reports which summarize our
6 efforts.

7 XII. DECLINING AND DISAPPEARING PRINT PROFILE

8 Q. During your years at Philip Morris USA, what steps has the company taken
9 to make sure its advertising was not being placed in publications that were
10 primarily directed to persons under 21?

11 A. Philip Morris USA and its advertising agencies have employed different practices
12 to assure that its ads were not being placed in publications primarily directed to persons
13 under the age of 21. For years, we have asked magazine publishers to provide us with a
14 certification that the magazine was not primarily directed to persons under 21 years of
15 age; we have reviewed the magazines themselves to get a sense of their content, editorial
16 and other advertising; and we have looked at demographic information for subscriptions
17 and circulation.

18 Q. Has Philip Morris USA change its media placement practices over time?

19 A. Yes. After the FDA proposed its standard for determining magazine eligibility,
20 we implemented more elaborate protocols to select magazines for our cigarette brand
21 advertising. For example, we began looking at certification data more frequently. And if
22 a publication passed our certification process in one year, that did not necessarily mean it
23 would pass in the next. In addition, we determined that for certain magazines, the

1 subscription data alone was inadequate because the magazines had a large percentage of
2 newsstand sales. So for those books, we also required circulation data. We also started
3 to take a harder look at magazines that presented close calls, by checking data more
4 frequently or asking the publishers to provide us with additional information. We also
5 instituted a practice of reviewing certain publications with senior management.

6 Q. At some point following the MSA, did Philip Morris USA change its
7 magazine certification criteria?

8 A. Yes.

9 Q. Let me show you JD-050766. What is this document?

10 A. This is a Philip Morris USA Media/Compliance summary, dated
11 December 10, 2003.

12 Q. Was it created in the regular course of Philip Morris USA's business?

13 A. Yes.

14 Q. What information is contained in JD-050766?

15 A. This document describes our media placement practice, as of December 10, 2003.
16 In 2000, we took two significant steps with respect to our media placement policy. The
17 first thing we did, in April of 2000, was to take all of our advertisements off of the back
18 covers of magazines. Shortly thereafter, in June of 2000, we adopted the criteria
19 proposed by the FDA for determining which magazines were eligible for our advertising.
20 Under the FDA criteria we adopted, which was based on readership rather than
21 circulation or subscribers, a magazine was not eligible for our cigarette brand advertising
22 if either: (1) more than 15 percent of its readership was under 18 years of age; or (2) more
23 than 2 million of its readers were under 18 years of age.

1 Q. Why did Philip Morris USA make these two changes to its media placement
2 policy?

3 A. We had been having discussions about magazine placement with the state
4 Attorneys General following the MSA. They informed us that they were concerned about
5 advertisements appearing on the back covers of magazines because those back-cover
6 advertisements might be seen by children in the home, or at a doctor's office or in some
7 other fashion, even if children do not actually read the magazine. The Attorneys General
8 were also concerned about high youth readership levels – as measured by syndicated
9 research. Although we had in the past stayed away from readership data, because of its
10 inherent unreliability, we wanted to be particularly sensitive to the concerns of the
11 Attorneys General. We chose the criteria proposed by the FDA because we felt those
12 criteria reflected a conservative approach to magazine advertising placement that would
13 be acceptable to the Attorneys General.

14 Q. Was Philip Morris USA required, by the MSA or any other law, to make
15 these changes to its media placement practices?

16 A. No.

17 Q. What is JD-048193?

18 A. This is a press release, dated June 5, 2000, issued by some of the state Attorneys
19 General to announce Philip Morris USA's decision to change its media placement
20 practice by adopting the proposed FDA readership criteria. The press release includes a
21 statement by Attorney General Gregoire praising Philip Morris USA's decision.

22 Q. As a result of these changes in 2000, how many magazines did Philip Morris
23 USA continue to advertise in?

1 A. By the year 2003, Philip Morris USA was advertising in 13 magazines.

2 Q. Within the last couple of years, did Philip Morris USA change its media
3 placement policy with respect to Marlboro?

4 A. Yes. In 2002, we made the decision to discontinue national magazine advertising
5 for our Marlboro brand.

6 Q. Did Philip Morris USA stop advertising Marlboro in newspapers, as well?

7 A. Yes.

8 Q. At some point subsequent to your decision to stop running Marlboro
9 advertisements, did Philip Morris USA change its magazine placement practice with
10 respect to its other cigarette brands?

11 A. Yes. In 2004 we made the decision to discontinue national magazine advertising
12 for all of our cigarette brands.

13 Q. Is there any law or other requirement that prohibits Philip Morris USA from
14 running national magazine advertising for its cigarette brands?

15 A. No. There is no law or other requirement that prevents us from advertising in
16 magazines targeted to adults.

17 XIII. PHILIP MORRIS USA'S ADULT SMOKER DATABASE

18 Q. Can you summarize your involvement with the Adult Smoker Database
19 during your career at Philip Morris USA?

20 A. Yes. The direct marketing group reported to me during a portion of my tenure as
21 Vice President of Marketing Research and Marketing Planning. As a result, I became
22 familiar with the way in which the Database was maintained and how it was used in our
23 direct mail efforts. As Vice President of Discount Brands and Vice President of

1 Marlboro Promotions, I ran direct marketing programs that were sent to adult smokers on
2 our Adult Smoker Database. As a member of the Senior Team since 1998, I have been
3 fully informed about significant changes to the company's policies with respect to the
4 Adult Smoker Database. Finally, since around October of 2002, the direct marketing
5 Database group has reported up through me.

6 A. THE ADULT SMOKER DATABASE AND HOW IT IS POPULATED

7 Q. What is the Philip Morris USA Adult Smoker Database?

8 A. The Adult Smoker Database is a database that is used by Philip Morris USA to
9 send mailings to qualified adult smokers 21 years of age or older who have told us they
10 would like to receive coupons, promotions and other cigarette brand offers.

11 Q. How long has the Database been in existence?

12 A. The Database was created in 1986, although the first branded mailing to adult
13 smokers using the Database did not go out until 1988.

14 Q. What is the purpose of Philip Morris USA's Adult Smoker Database?

15 A. The Database allows us to communicate directly with adult smokers in an effort
16 to build a relationship with them. If they are already smokers of a Philip Morris USA
17 cigarette brand, we hope to build a relationship in order to increase their loyalty to that
18 brand. If they are smokers of a competitive brand, we hope to build a relationship so that
19 they will consider purchasing one of our brands instead. The Database also allows us to
20 sort smoker names by regular brand or other characteristics so that we are better able to
21 send adult smokers direct mail offers that they will find appealing.

22 Q. Does the Database have any additional benefit to Philip Morris USA today?

1 A. Yes. Over time, as we have reduced the overall visibility of our marketing
2 communications, the Database serves as the primary vehicle for private and direct
3 communications with adult smokers 21 years of age and older. The result has been that
4 Philip Morris USA has drastically reduced the visibility of cigarette brand marketing to
5 people who are not adult smokers.

6 Q. As of the time of the first Database marketing mailing, what has been the
7 basic eligibility requirement for someone who wants to receive marketing mailings?

8 A. In order to receive marketing mailings, the person has to be a smoker 21 years of
9 age or older.

10 Q. Why did Philip Morris USA set the minimum age at 21, rather than legal
11 age?

12 A. Because this is an area where we can exercise control over who receives brand
13 communications from us, we wanted to provide an extra buffer.

14 Q. How does Philip Morris USA obtain names for the Adult Smoker Database?

15 A. Today, there are a number of ways in which adult smokers who wish to
16 participate in our marketing programs can have their names added to the Database. For
17 example, they can have their information collected at one of our bar programs or events,
18 they can go on SmokerSignUp.com to add their name, they can call an 800 number to add
19 their name, or they can indicate in a third-party survey that they are interested in
20 receiving tobacco coupons and other promotional materials. For each of these name-
21 generation methods, there is a set of procedures we follow to try to make sure that the
22 person is eligible to be on our mailing list, that is, that they are an adult smoker 21 years

1 of age or older. This list is not all inclusive, but every method requires either a
2 government issued identification or electronic age verification.

3 Q. How does someone sign up for the Database at one of Philip Morris USA's
4 events?

5 A. We have contracted outside vendors who have been trained on Philip Morris USA
6 and MSA marketing practices. An adult smoker age 21 and over must complete and sign
7 a survey, including an age verification, and present a government issued identification to
8 the vendor. These contractors are responsible for checking the government issued
9 identification for each person who wants to be added to the Database, both to verify that
10 the person is using their own government issued identification and that it shows they are
11 at least 21 years of age. The vendors either copy or scan the government issued
12 identification for Philip Morris USA's records with the consent of the adult smoker.

13 Q. How does someone sign up for the Database on Philip Morris USA's
14 SmokerSignUp website?

15 A. Using the technology of our electronic age verification (EAV) vendor, the person
16 must answer certain questions designed to verify both their identity and their age through
17 the use of government information and private databases.

18 Q. How does the EAV vendor confirm that an individual is at least 21 years of
19 age?

20 A. The EAV vendor conducts a two-stage evaluation. The first stage is intended to
21 authenticate the identity an applicant provides by making sure they are who they say they
22 are. The idea is to prevent someone from using another person's identity to enroll in our

1 Database. Once an applicant's identity is authenticated, the second stage is intended to
2 verify that the applicant is at least 21 years of age.

3 Q. How does the EAV vendor verify the applicant's age?

4 A. The EAV vendor utilizes several government and private databases to match the
5 identity information with records like driver's license, motor vehicle registration, voter
6 registration records and credit records. If the EAV vendor determines that the applicant
7 is 21 years of age or older, an affirmation of identity and age will be returned to Philip
8 Morris USA. If the EAV vendor determines that the applicant is younger than 21 years
9 of age, that person will not be added to the qualified segment of the Database.

10 Q. How does someone sign up for the Database over the telephone?

11 A. The person calls a toll free number and must provide information necessary for
12 our operators, who are trained to provide the data to the EAV vendor in order to verify
13 the applicant's identity and their age.

14 Q. How does Philip Morris USA verify the age of persons who have indicated in
15 a third-party survey that they are interested in receiving tobacco coupons and other
16 promotional materials?

17 A. We purchase names of persons who have identified themselves as smokers over
18 the age of 21 who wish to receive marketing communications for tobacco products. Here
19 too, we utilize our EAV vendor to verify that the person is actually 21 years of age or
20 older.

21 B. CLASSIFICATION OF DATABASE NAMES

22 Q. How many names are on the Adult Smoker Database?

23 A. Today, there are approximately 37.7 million total names on our Database.

1 Q. Does the Marketing Department send direct mail to all of those names?

2 A. No. The Marketing Department is only able to send direct mail to names on the
3 "available and qualified" segment of the Database. That segment of the Database, about
4 26 million names, is comprised of smokers 21 years of age and older. The balance of
5 names on the Database are for individuals to whom we will not send brand-related direct
6 mail for any number of reasons, including incomplete mailing information, lack of age
7 verification, or notice that the individual has asked to be taken off our mailing list.

8 Q. Why do you keep people on your Database if the Marketing Department
9 cannot mail to them?

10 A. The majority of those names are unavailable, meaning we no longer have their
11 current address. We retain those names for a period of time so that we can make attempts
12 to obtain their current address. In addition, we maintain nonqualified names, including
13 those underage persons who have attempted to get on our qualified list by
14 misrepresenting their age. We do this primarily in order to thwart any similar future
15 efforts by those individuals to get on our qualified list.

16 Q. What does it mean for a Database name to be qualified?

17 A. That means that for all names added to the Database after December 9, 1999, the
18 individual has either submitted a government issued identification (GIID) or has been
19 electronically age verified by our EAV vendor to have a date of birth 21 years of age or
20 older. For those names that came onto our Database before December 9, 1999, the
21 individual has signed a verification that they are a smoker 21 years of age or older and
22 has submitted a date of birth equal to 21 years of age or older. Today we have
23 approximately 26 million qualified adult smoker names on our Database, and for

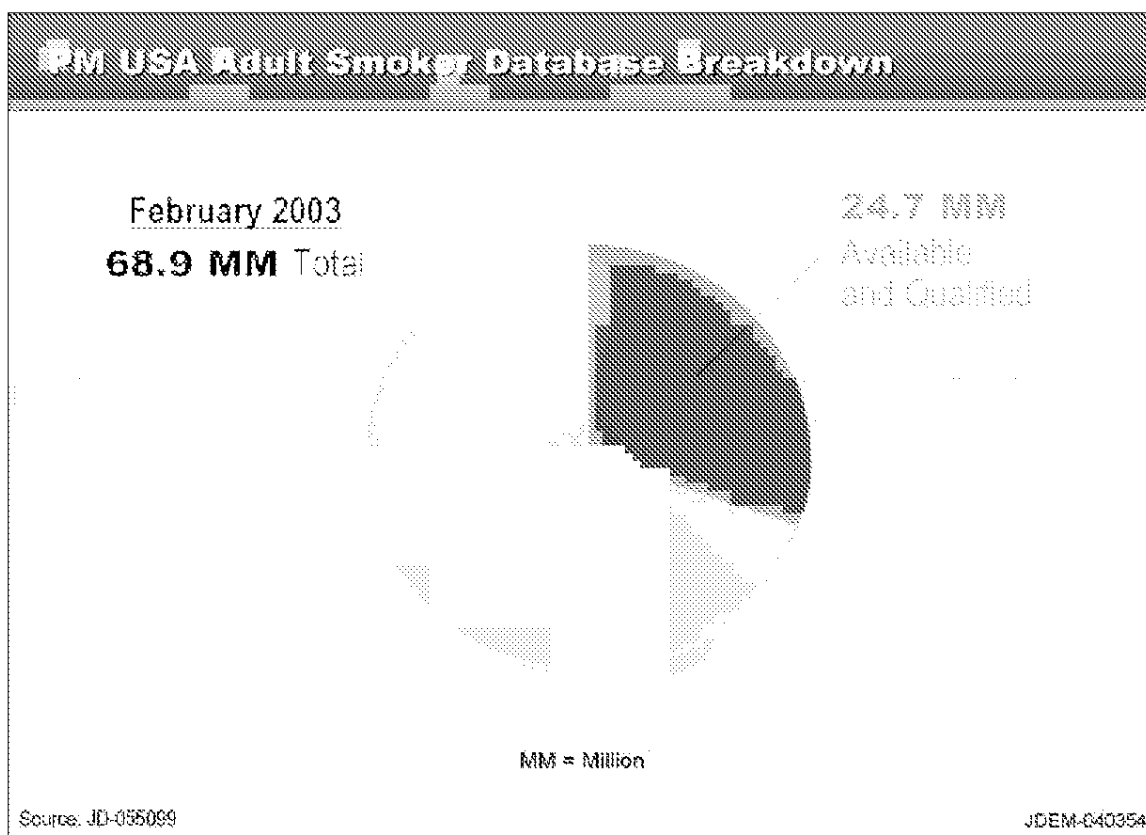
1 approximately 85 percent of those we have either a government issued identification or
2 outside age verification through our EAV vendor. We continue to look for ways to
3 obtain either government issued identification or third party verification as to the
4 remaining 15 percent of qualified adult smokers.

5 Q. What does it mean for a qualified Database name to be available?

6 A. What that means is that the qualified name has a deliverable address and can
7 receive mail.

8 Q. Have you helped to prepare a demonstrative concerning the classification of
9 names on the Adult Smoker Database? JDEM-040354.

10 A. Yes, I have.



11
12 Q. What does this demonstrative show?

1 A. This demonstrative shows, as of the February 2003 Snapshot made available in
2 this case, that only a portion of the total names on the Database are available and
3 qualified and that only this segment of the Database can receive mail from us.

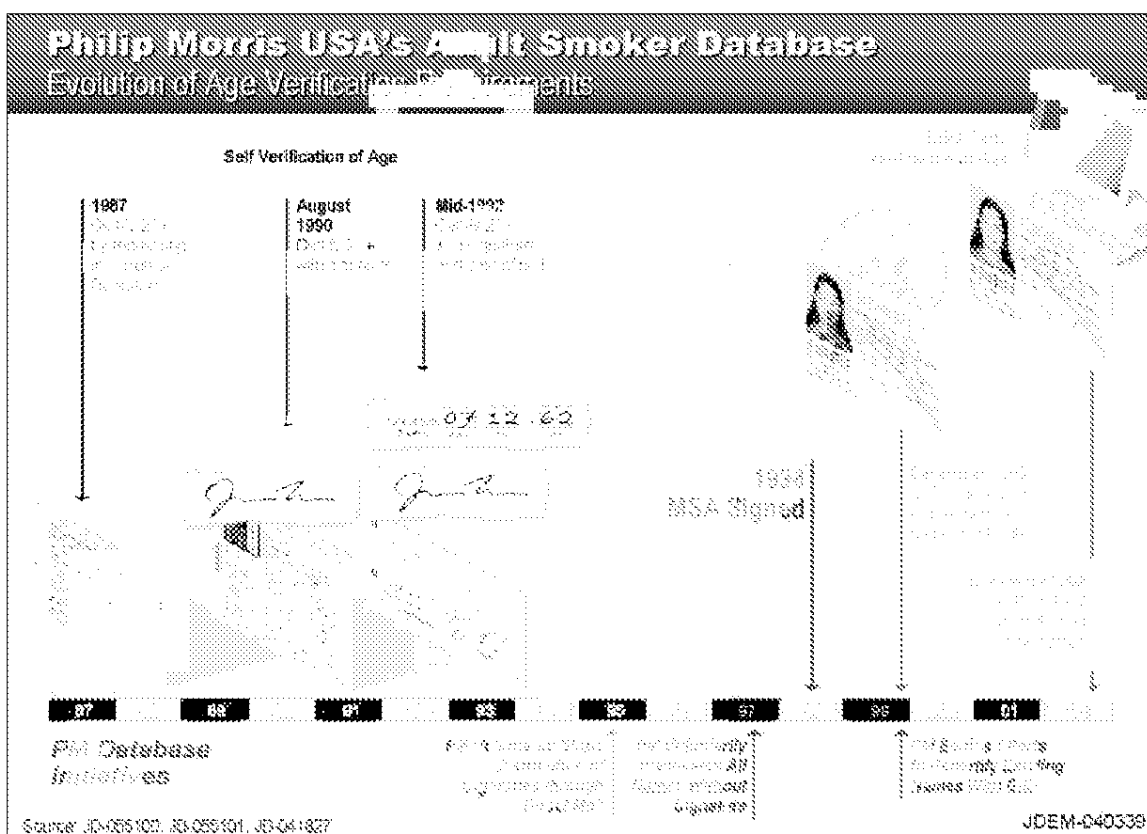
4 C. OVERVIEW OF EVOLUTION OF AGE VERIFICATION
5 REQUIREMENTS

6 Q. What has Philip Morris USA done to try to ensure that only smokers 21
7 years of age and older are qualified to receive its marketing mailings?

8 A. Our age verification requirements have evolved from a form of self-verification of
9 age to third party verification of age through the use today of government issued
10 identification and/or EAV. Over the years, we have identified ways to improve our age
11 verification requirements that have made it more difficult for an underage person to
12 misrepresent their age in order to get on our Database. Our goal has been to implement
13 improvements as we have learned better ways to ensure that only smokers 21 years of age
14 and older receive marketing mailings.

15 Q. Have you helped to prepare a demonstrative to illustrate what you are
16 talking about? JDEM-040339.

17 A. Yes.



1

2 Q. What does this demonstrative show?

3 A. This is a timeline showing the evolution of increasingly more stringent age
4 verification requirements over time for anyone who wishes to be eligible to receive
5 marketing mailings from us.

6 Q. What early steps did Philip Morris USA take to ensure that only smokers 21
7 years of age and older were qualified to receive your marketing mailings?

8 A. Starting in 1987, we informed any person interested in signing up for the
9 Database that by requesting inclusion on our Database he or she was certifying that he or
10 she was a smoker 21 years of age and older. The form smokers sent in to request
11 inclusion on the Database included language that stated: "By returning this form, I
12 certify that I am a cigarette smoker 21 years of age or older." This began a multi-year

1 period during which Philip Morris USA used a self-verification of age procedure as the
2 foundation for its Adult Smoker Database.

3 Q. Is JD-055100 an example of a form containing this certification language?

4 A. Yes.

5 Q. Did Philip Morris USA subsequently change that eligibility requirement?

6 A. Yes. Beginning in August of 1990, the qualification form was changed to require
7 a signature to verify age. The new form had language such as the following: "By
8 responding to the following survey and signing below, I certify that I am a cigarette
9 smoker 21 years of age or older. I am also willing to receive free samples of cigarettes
10 and incentive items in the mail, subject to applicable state and federal law."

11 Q. Is JD-055101 an example of a form containing this signature certification
12 requirement?

13 A. Yes.

14 Q. Did Philip Morris USA subsequently change the age verification requirement
15 again?

16 A. Yes.

17 Q. Let me show you JD-041826 and JD-050586. What are these documents?

18 A. The first document is a memorandum dated June 22, 1998, prepared by the Direct
19 Marketing Group summarizing certain changes to the age verification process. The
20 second document is a memorandum dated January 10, 2003, from Sonya Rush
21 summarizing our age verification requirements and practices over time.

22 Q. What do these documents show?

1 A. These documents show that by the time of the MSA in 1998, we had made several
2 changes so that Philip Morris USA's practice was to require a signed verification form
3 that included date of birth in order to receive marketing mailings. For example, in 1997,
4 Philip Morris USA inactivated all names received prior to August of 1990 for which no
5 signed age verification had been obtained. In addition, in cases where Philip Morris USA
6 contractors had direct face-to-face interaction with adult smokers wishing to join the
7 Database, a visual inspection of government issued identification was required.

8 D. THIRD PARTY VERIFICATION OF AGE REQUIREMENTS

9 Q. Does Philip Morris USA believe that its self verification of age procedures
10 kept people under the age of 21 off of the Database?

11 A. Yes. Over the years, we were convinced that the system was working well. Only
12 occasionally did we receive information that a person under the age of 21 was on our
13 Database. This was the case for several reasons: As an initial matter, no one under the
14 age of 21 could get their name on the Adult Smoker Database unless they intentionally
15 misrepresented that they were a smoker 21 years of age or older. In addition, several of
16 the programs through which names were obtained for the Database involved face-to-face
17 dealings, which over time required smokers to show GIID. More importantly, as I will
18 discuss later in my testimony, our recent in-depth analysis of the self-certified Database
19 population has clearly established that only a very small percentage of the names on the
20 Database were under the age of 21.

21 Q. Regardless of your belief in the integrity of the self verification of age
22 procedures being followed by Philip Morris USA, did Philip Morris USA constantly

1 strive to make improvements that would make it even more difficult for people
2 under the age of 21 to get their names on the Adult Smoker Database?

3 A. Yes, we did.

4 Q. As a result of the MSA, in 1999, did Philip Morris USA make a major
5 decision regarding the age verification requirements of its Database?

6 A. Yes. Philip Morris USA made a decision to engage in substantial efforts to
7 convert its Database from a self-verification of age system to a third party-verification of
8 age system. Our purpose was to enhance our ability to prevent people under the age of
9 21 from getting their names on our Database.

10 Q. Did Philip Morris USA change its Database eligibility requirement as part of
11 this move to third party verification of age?

12 A. Yes. Since December of 1999, Philip Morris USA has instituted a third party age
13 verification procedure in order to improve its Adult Smoker Database. In accordance
14 with the MSA, Philip Morris USA has collected and maintained proof of age, in the form
15 of a copy of an individual's government-issued identification containing the individual's
16 name, address, date of birth and signature before we send that individual any gift item or
17 continuity merchandise in the mail in exchange for proofs of purchase. However, Philip
18 Morris USA's requirements go beyond the requirements of the MSA. While the MSA
19 only requires that smokers be legal age or older in order to receive continuity
20 merchandise, Philip Morris USA maintains its more stringent requirement that any
21 smoker participating in our continuity programs must be 21 years of age and older. In
22 addition, beginning in December of 1999, Philip Morris USA voluntarily required that
23 any individual who wants his name added to the Database -- not just the smoker who

1 sends in proofs of purchase for continuity merchandise -- must submit a signed smoker
2 verification form and a copy of his government-issued identification.

3 Q. Did Philip Morris USA recently offer another option for adult smokers to
4 provide third party verification of age?

5 A. Yes. Since 2002, we have offered smokers the option to verify age using our
6 EAV vendor.

7 Q. Why did you decide to give smokers the option of Electronic Age Verification
8 or EAV?

9 A. For a number of reasons. We found that some smokers did not want to provide a
10 GIID. In addition, after significant study, we determined that EAV was just as effective
11 as collecting government-issued identification.

12 E. EFFORTS TO RE-CERTIFY EXISTING NAMES ON THE DATABASE

13 Q. After Philip Morris USA made the decision to require third party
14 verification of age in 1999, did you do anything to address qualified names that were
15 added to the Database prior to 1999?

16 A. Yes. We engaged in substantial efforts to obtain third party verification of age for
17 previously qualified names.

18 Q. Can you describe those efforts?

19 A. From 1999 until December of 2004, these efforts included a number of
20 requalification mailings, whereby smokers on the Database were offered incentives to
21 submit a photocopy of their GIID; special event programs, whereby smokers were
22 solicited by contractors working on behalf of Philip Morris USA and offered the
23 opportunity to submit GIID; and a retail recertification program, conducted in thousands

1 of retail outlets across the country, whereby smokers were intercepted after making a
2 cigarette purchase and offered a coupon for a future purchase in exchange for a
3 photocopy of their GIID. During the past few months, we conducted EAV for the
4 remaining qualified adult smokers on the Database who had neither provided GIID nor
5 been through EAV previously. The company, in total, has spent over \$90 million on
6 these efforts during the past six years.

7 Q. Are you familiar with the results of the most recent EAV efforts?

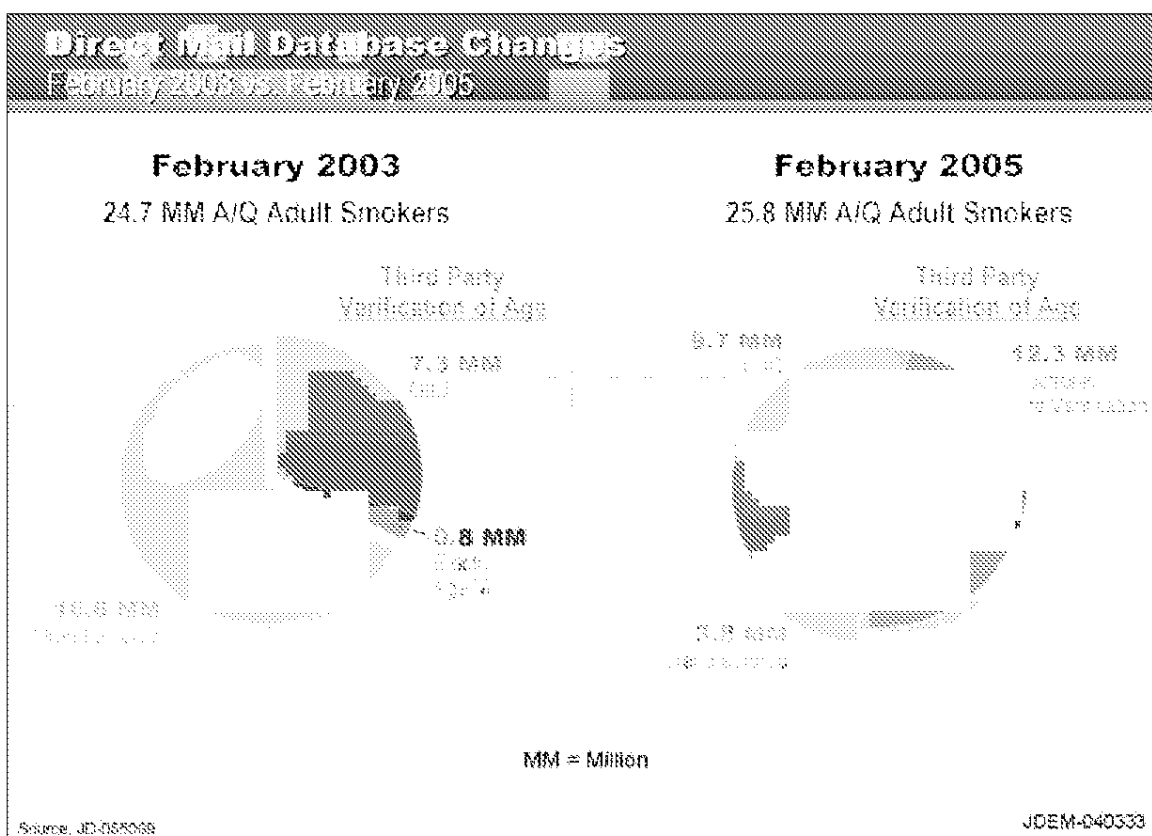
8 A. Yes. In fact, I personally supervised the team that implemented the recent EAV
9 efforts.

10 Q. What were the results of those efforts?

11 A. We took a system that was primarily based on self-verification of age in 1999,
12 and have largely converted it to a system based upon third party verification of age. As
13 of today, approximately 85 percent of the qualified names now on our Database have
14 supplied third party verification of age through either GIID or EAV.

15 Q. Have you helped to prepare a demonstrative depicting the results of your
16 efforts to recertify the Database? JDEM-040333

17 A. Yes, I have.



1

2 Q. What does this demonstrative show?

3 A. This shows that from the time of the Department of Justice's inspection of the
4 Database, which I will discuss later, we have been able to grow the number of smokers
5 for whom we have third party verification of age almost threefold, from approximately
6 8.1 million to approximately 22 million adult smokers.

7 Q. What is Philip Morris USA's plan with respect to the other 15 percent, who
8 were added to the Database prior to December 9, 1999, and for which Philip Morris
9 USA does not have either GIID or EAV?

10 A. Because we have a signed verification of age and date of birth for those names,
11 they remain on our qualified list and can receive marketing mailings. As I explained
12 above, the self verification of age system was a sound system that resulted in very few

1 underage people misrepresenting their age in order to get their names on the Adult
2 Smoker Database. However, we are continuing to make efforts to obtain third party
3 verification of these remaining names.

4 F. HOW CAN SMOKERS REMOVE THEIR NAMES FROM PHILIP
5 MORRIS USA'S MAILING LIST?

6 Q. The Government has alleged that Philip Morris USA wants as many names
7 as possible on its Adult Smoker Database, regardless whether those are names of
8 nonsmokers or persons under legal smoking age. What is your response to that
9 allegation?

10 A. It is not true. In fact, we work very hard to keep both nonsmokers and persons
11 under the age of 21 off of our Database. We only want the names of adult smokers who
12 are interested in receiving marketing communications and who are likely to respond to
13 our brand mailings. To this end, we provide mechanisms for persons who are no longer
14 interested in receiving marketing communications from Philip Morris USA or for
15 smokers who have expressed an interest in quitting, to request that their names be
16 removed from the available and qualified segment of the Database.

17 Q. What mechanisms does Philip Morris USA provide to smokers who no
18 longer want to receive marketing communications through the Adult Smoker
19 Database?

20 A. Since at least 2002, every marketing mailing to adult smokers on the Database has
21 included language stating that they can call an 800-number to remove their name from
22 the mailing list.

23 Q. Is JD-053407 an example of those mailings?

1 A. Yes.

2 Q. Has Philip Morris USA done anything else to provide smokers with an
3 opportunity to have their names removed from the available and qualified segment
4 of the Database?

5 A. Yes. In 2003 we sent an opt-off mailing to 6.5 million smokers who had not
6 responded to our mailings in the last five years, asking if they wanted to remove their
7 name from the mailing list. In 2004, we followed up with a mailing to 1.2 million
8 smokers on our Database.

9 G. THE GOVERNMENT'S QUERIES RUN ON THE ADULT SMOKER
10 DATABASE

11 Q. Are you generally aware that as part of the discovery process in this case,
12 Philip Morris USA made its Adult Smoker Database available for inspection to the
13 Department of Justice?

14 A. Yes, I am.

15 Q. Are you aware that as part of this discovery process, the Department of
16 Justice provided Philip Morris USA with queries to run on the Database?

17 A. I am aware of that.

18 Q. Did Philip Morris USA run the queries as requested by the Department of
19 Justice and provide the results to the Department of Justice?

20 A. Yes.

21 Q. What is your understanding of the nature of these queries?

22 A. My understanding is that the Department of Justice submitted certain search
23 requests that appeared to be related to the subject matter of whether Philip Morris USA

1 was using its Adult Smoker Database to market cigarette brands to persons who are under
2 legal age.

3 Q. I am going to show you certain findings of fact which the Department of
4 Justice has presented to this Court regarding the results of its queries of the Philip
5 Morris USA Adult Smoker Database and ask you some questions. Let me start with
6 United States' Final Proposed Finding of Fact No. 4285 which reads as follows:

7 Philip Morris USA has knowledge that many individuals whose
8 records contained on its Direct Mail Marketing Database and who
9 had a "signature" on record to "verify" that they were age 21 or
10 above were in fact under the age of 21 at the time they received
11 marketing mailings from Philip Morris. Nonetheless, Philip
12 Morris, continued to send these individuals marketing mailings. In
13 1993 alone, Philip Morris USA sent 306,895 mailings to
14 individuals who were under the age of 21 at the time they
15 received the mailing, despite also having a "signature" on record to
16 "verify" that they were 21 or above. 3000196011-6025 at 6014
17 (U.S. Ex. 23,056) (Confidential) (U.S. Ex. 23,059) (Confidential).
18 Of these mailings, 173,432 were coupons, 96,906 were gifts or
19 "continuity" items (such as t-shirts, posters, or mugs), and 18,820
20 were products. 3000196011 at 6016 (U.S. Ex. 23,056)
21 (Confidential (U.S. Ex. 23,059)

22 Q. I want to focus you on the Government's allegation that Philip Morris USA
23 intentionally sent marketing mailings to people that it knew were under the age of
24 21. Based on your knowledge of the Adult Smoker Database, is this allegation true?

25 A. No, it is not.

26 Q. How many individuals did Philip Morris USA send marketing mailings to,
27 knowing at the time of the mailing that the individuals were under the age of 21?

28 A. There were none.

29 Q. First, would you please generally explain why that is?

1 A. As I have described above, we have detailed procedures in place that are carefully
2 designed to ensure that only adult smokers age 21 and older are placed on the qualified
3 segment of the Adult Smoker Database and thus able to receive direct mail. The only
4 way that someone can be on the qualified segment of the Database who is actually under
5 the age of 21, is if the applicant falsely represented his or her age to Philip Morris USA
6 or if Philip Morris USA made an unintentional clerical error. Either way, Philip Morris
7 USA would not be aware that such a person was under the age of 21 at the time they were
8 sent direct mail through our Adult Smoker Database.

9 Q. In reviewing Finding of Fact No. 4285, based on your knowledge of the
10 Database, did you discover a flaw in the Government's interpretation of its search
11 results?

12 A. I did.

13 Q. Please explain that flaw.

14 A. For purposes of its queries, the Government assumed that the current date of birth
15 contained in the Adult Smoker Database for a given smoker was the same date of birth
16 contained in the Database at the time of every earlier mailing to that smoker. As a result
17 of this assumption, the Government appears to conclude that Philip Morris USA
18 knowingly sent direct mail to approximately 380,000 people under the age of 21.
19 However, this assumption is incorrect. In fact, our practice required each of these adult
20 smokers to provide an age verification form before being qualified to receive marketing
21 mailings from us. Therefore, there would have been an indication in the Database that
22 established that at the time of each earlier mailing, that person was certified as being at
23 least 21 years of age.

1 Q. Please explain how and why this occurred.

2 A. As a matter of Database policy, every time a smoker responds to a mailing by
3 filling out a form that requires him to provide his date of birth, the Database vendor must
4 reenter the date of birth into the Database for that smoker. As a result, the records for
5 some adult smokers may show a current date of birth that is different from the age
6 verification form that we initially received.

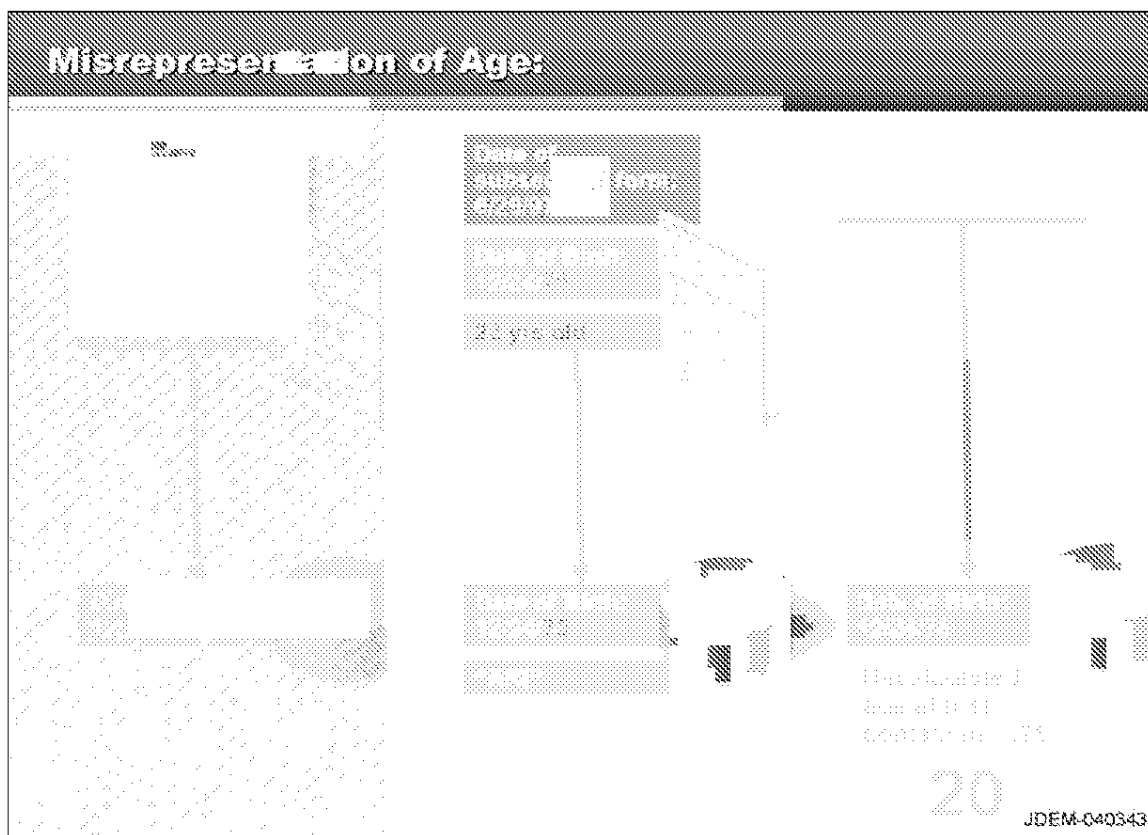
7 Q. Why would the date of birth for a particular smoker change from what was
8 entered when the smoker signed up for the Database?

9 A. The first and most prominent reason for different dates of birth being in the
10 Database records for the same person is because a very small percent of people applied
11 for admission to the Database by using an incorrect or intentionally false date of birth that
12 made them appear to be older than they actually were. As part of Philip Morris USA's
13 various direct mail programs, smokers on the Database are requested to fill out frequent
14 surveys as time goes by and they participate in various programs. This small percent of
15 people who had provided an incorrect or intentionally false date of birth at an earlier
16 point in time could correct the date of birth in a subsequent survey they were requested to
17 complete. The second reason for different dates of birth being in the Database for the
18 same person is because of clerical errors, normally resulting from keypunch error or
19 illegible handwriting. For either reason, the net result is that at the time Philip Morris
20 USA mailed materials to such people, Philip Morris USA's Database reflected that the
21 person was 21 years or older, and accordingly Philip Morris USA did not know that it
22 was mailing materials to someone under the age of 21.

1 Q. Would please give the Court a concrete illustration of the age falsification
2 example that you have just described?

3 A. A person who was 20 years old could sign up for the Database by submitting an
4 age verification form on December 25, 1995, certifying that they were born on December
5 24, 1974 – making that person appear to be 21 years old. In fact, unknown to Philip
6 Morris USA, that person was actually born on December 24, 1975, making that person
7 only 20 years old. Two years later, that person could fill out a survey in connection with
8 one of Philip Morris USA's direct mail marketing programs. On that survey, the person
9 would correctly report they were born on December 24, 1975, making that person 22
10 years old in 1997. When the Department of Justice search queries were run on the
11 Database in 2003, the only date of birth that would appear in the Database would be the
12 last recorded date of birth for that person – December 24, 1975. The Department of
13 Justice appeared to have made the incorrect assumption that the December 24, 1975 date
14 of birth had been in the Database at the time of all earlier mailings to this person –
15 therefore assuming such mailings were sent to someone under the age of 21. That was an
16 incorrect assumption.
17

- 1 Q. Let me show you JDEM-040343. What does this show?
- 2 A. Yes. This is a demonstrative that depicts the age falsification example including
- 3 the Department of Justice's misinterpretation of the search results.

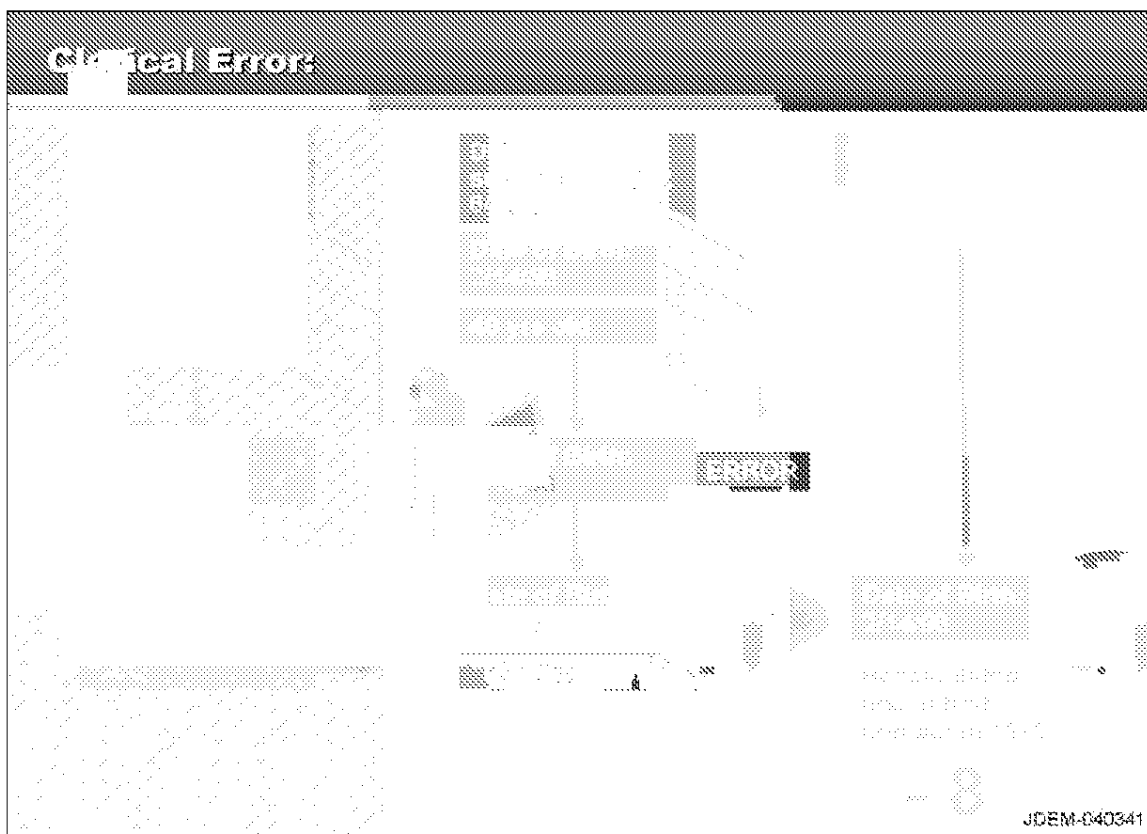


- 4
- 5 Q. Can you give a concrete example of how a clerical error can impact age
- 6 verification?
- 7 A. Yes. Clerical errors can occur if, for example, someone keying in data from an
- 8 age verification form incorrectly types a date. For example, a smoker enters the Database
- 9 in 1990 indicating a date of birth of 2/14/1958. A few years later, he submits another
- 10 form repeating his data of birth as 2/14/1958. However, in data entry, his date of birth is
- 11 keyed in as 2/14/1998. At that time, his date of birth would incorrectly make him

1 ineligible. However, if you apply the 1998 date of birth retroactively, it would suggest
2 that he was -8 years old when he entered the Database.

3 Q. Let me show you JDEM-040341. Is this the demonstrative that you helped
4 prepare depicting an example of how a clerical error would impact age verification?

5 A. Yes. This is a demonstrative that depicts the clerical error example, including the
6 Department of Justice's misinterpretation of the search results.



7
8 Q. Let me show you JDEM-040346. Is this a demonstrative exhibit that has
9 been prepared under your direct supervision to summarize your factual analysis of
10 this Adult Smoker Database issue that you described above.

11 A. Yes, it is.

Age Break of Response to DOJ Query V.b and VI.b

Recalculated Age at First Contact	V Count (under 21)
8	8
7	28
6	90
5	202
4	325
3	485
2	728
1	1,077
0	2,936
1	1,401
2	1,187
3	961
4	836
5	741
6	685
7	736
8	725
9	742
10	817
11	1,073
12	1,613
13	2,473
14	4,313
15	7,970
16	14,056
17	24,553
18	47,493
19	91,578
20	170,197
Total:	380,029

Source: JD-053421

JDEM-040346

1

1 Q. Would you please explain to the Court the significance of this demonstrative
2 exhibit in addressing the Department of Justice's allegation that Philip Morris USA
3 knowingly sent direct mail to people under the age of 21?

4 A. As this demonstrative reflects, if you just accepted the Government's assumption
5 that the latest date of birth in the Database was the date of birth that existed at the time of
6 every earlier mailing, and you used that latest date of birth to calculate the age of smokers
7 at the time of earlier mailings, there would be thousands of people in our Database that
8 had not yet been born at the time of the earlier mailings. This, of course, is not possible.
9 Instead, Philip Morris USA must have been relying on other age verification information
10 that the person was at least 21 years of age at the time of the earlier mailings.

11 Q. Let me show you U.S. Ex. 23,056 that is cited above in the Government's
12 Finding of Fact 4281 that I called to your attention above. Directing your attention
13 to the page that is Bates stamped 6016, please tell me how many people does the
14 Government contend received mailings when the Database supposedly reflected that
15 the people receiving the mailings were under the age of 21?

16 A. 380,029.

17 Q. Would you please tell the Court what you have done to determine if there
18 was actually an earlier date of birth recorded on the Database at the time of the
19 earlier mailings to these 380,029 people?

20 A. I directed a project to identify the age verification forms submitted by these
21 380,029 people in order to determine whether the date of birth contained in the Database
22 at the time of the Department of Justice's Database queries was the information that
23 Philip Morris USA relied upon in determining the person's age for prior mailings. We

1 have been searching through over 200 million forms to locate the age verification forms
2 submitted by these individuals.

3 This has been a time-consuming and expensive undertaking – costing
4 Philip Morris USA approximately \$11 million to date. As of today, we have located the
5 age verification forms for approximately 206,000 of the individuals in this group. Each
6 one of the 206,000 had an age verification form in the Database that reflects that when
7 mailings were made, the person was 21 years or older. We were able to make this
8 determination because each age verification form shows the date it was completed. We
9 are continuing this project to locate as many of the remaining age verification forms as
10 possible.

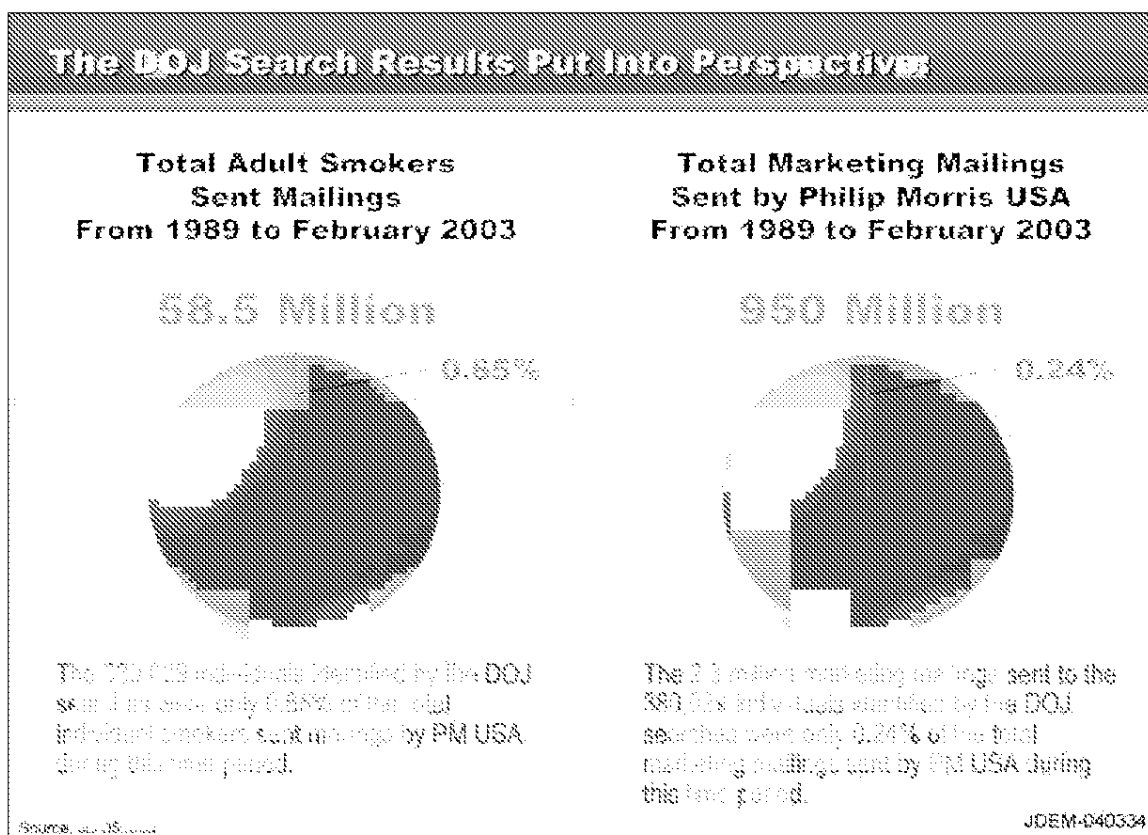
11 Q. Even if you assume that the 380,029 people were under the age of 21 at the
12 time of the mailings referenced above by the Department of Justice, have you
13 prepared a demonstrative exhibit that would put this number into perspective by
14 comparing it to the total number of people on the Adult Smoker Database who
15 received mail during the relevant timeframe?

16 A. Yes, I have.

17 Q. I would like to show you JDEM-040334, and ask you to explain this chart to
18 the Court.

19 A. This chart shows that between 1989 and February, 2003 Philip Morris USA sent
20 mailings to approximately 58.5 million smokers who were on the Adult Smoker
21 Database. The 380,029 individuals identified in the searches comprise 0.65 percent of
22 that total. The chart also shows that Philip Morris USA sent approximately 950 million
23 mailings to the 58.5 million smokers. The 380,029 individuals identified through the

1 queries received approximately 2.3 million marketing mailings – or 0.24 percent of that
2 total.



3

4 Q. Would you please tell the Court what this demonstrative exhibit shows as far
5 as Philip Morris USA using its Adult Smoker Database to market its cigarette
6 brands to people under the age of 21?

7 A. I believe this confirms my testimony above that, even assuming that the numbers
8 cited in the Government's Proposed Findings of Fact are accurate, only a very small
9 percentage of people on the Database who received mail were under the age of 21.

10 Q. Let me show you JDEM-040141. What information is reflected on this
11 demonstrative?

1 Q. Of the 380,029 individuals identified in the Government's queries as having
2 received mail from 1989 to 2003, do you know how many were available and
3 qualified to receive mail as of the time the Government conducted its searches?

4 A. Yes. By looking at the same Database information made available to the
5 Government we can see that approximately 175,000 were qualified and available on our
6 Database to receive mail. Conversely, approximately 205,000 were not able to receive
7 mail from us. This means that over time we received information about these 205,000
8 individuals that made them ineligible to receive marketing mailings from us, such as
9 information that led us to conclude that they were underage.

10 Q. Let me show you another one of the Government's findings of fact. I am now
11 showing you Finding of Fact No. 4277, which states as follows:

12 Despite its supposed policy which prevents it from
13 sending mailings to individuals under age 21, Philip
14 Morris USA has sent mailings to many individuals
15 under the age of 21. In fact, Philip Morris USA has
16 sent *Marlboro Unlimited* to many individuals who Philip
17 Morris USA knew were under the age of 21 at the time
18 they received it. For example, in 1999 alone, Philip
19 Morris USA sent *Marlboro Unlimited* to 37,826
20 individuals who were under the age of 21, according to
21 Philip Morris USA's own records. PM3000196011-
22 6025 at 6016 (U.S. Ex. 23,056)(Confidential) (US Es.
23 23,059)(Confidential).

24 Is this an accurate statement by the Government?

25 A. No. For all of the reasons discussed above, I am not aware of any facts that
26 establish that Philip Morris USA ever knew at the time of the mailing that it was sending
27 the *Unlimited* magazine to people under the age of 21.

1 Q. By the way, Mr. Beran, does Philip Morris USA still send the *Unlimited*
2 magazine to smokers on the Database?

3 A. No. We discontinued the magazine at the end of 2004. The last issue was the
4 Winter 2004 issue.

5 XIV. CONTINUITY PROGRAMS AND DIRECT MAIL

6 A. CONTINUITY PROGRAMS

7 Q. What are continuity programs?

8 A. Continuity programs are any programs that provide consumers with some type of
9 reward in exchange for the accumulation of points or miles or proofs of purchase.

10 Q. How does Philip Morris USA use continuity programs as part of its cigarette
11 brand marketing efforts?

12 A. We utilize catalog programs for some of our brands, whereby adult smokers can
13 save up proofs of purchase to send in for incentive merchandise of various types. This is
14 part of the promotions element of the brand value equation I described earlier. Our
15 biggest continuity programs have been those offered for our Marlboro brand. With
16 respect to Marlboro, our continuity programs were initially developed to provide an
17 additional benefit to adult smokers who choose to smoke the Marlboro brand. The hope
18 was that young adult smokers, ages 21-24, in particular would take advantage of those
19 programs. Although the Marlboro brand continuity programs have been successful, the
20 primary participants in the programs were older adult smokers, not younger adult
21 smokers. This is largely because older adult smokers are looking for additional ways to
22 receive value from their cigarette purchases. One way for them to do so is by buying
23 discount brands. Another way for them to do so is to get something additional for their

1 money. As a result of the older age of continuity program respondents, our continuity
2 programs have turned into a means for us to retain the loyalty of older adult smokers who
3 might otherwise have made the switch to discount brands.

4 Q. What are some of Philip Morris USA's catalog programs?

5 A. For the Marlboro brand, we have had a series of catalog programs. The Marlboro
6 Adventure Team program was introduced in January of 1993. It was followed by other
7 Marlboro catalog programs like the Marlboro Country Store and Marlboro Gear
8 programs. Other brands, like Merit, Benson & Hedges, Basic, Virginia Slims and
9 Parliament, have also offered catalog programs.

10 Q. Let me show you JD-052850. What is this document?

11 A. It is the catalog for the Marlboro Gear 2004 program.

12 Q. As part of your responsibilities, do you receive data concerning the
13 demographic composition of Marlboro continuity program participants?

14 A. Yes.

15 Q. Do you know what percentage of the smokers who participated in the
16 Marlboro Gear 2004 continuity program were between the ages of 21 and 24?

17 A. Yes, approximately 1.5 percent. This means that 98.5 percent of the smokers who
18 participated in the program were over the age of 24.

19 Q. Do you know the percentages of smokers between the ages of 21 and 24 who
20 participated in earlier Marlboro continuity catalog programs?

21 A. Yes. It was approximately 15% for the first catalog program in the early 1990s
22 and has declined steadily to the current rate of approximately 1.5%.

1 B. DIRECT MAIL

2 Q. How does Philip Morris USA use direct mail?

3 A. Direct mail is also part of the promotions element of the brand value equation I
4 described earlier. Philip Morris USA uses direct mail as a way to send private
5 communications to adult smokers who have told us they are interested in receiving
6 cigarette brand coupons and other mailings.

7 Q. How long has Philip Morris USA used direct mail as part of its cigarette
8 brand marketing efforts?

9 A. We have been using direct mail since the late 1980s. However, we really began
10 to increase our direct mail marketing throughout the 1990s.

11 Q. What is the value to Philip Morris USA of direct mail marketing over other
12 marketing vehicles?

13 A. Direct mail provides an opportunity to maintain and build upon a brand's
14 relationship with adult smokers. Today, it is the primary way for adult smokers to
15 receive certain promotional offers or to receive opportunities to participate in experiential
16 programs, like trips to the Marlboro Ranch or the Marlboro Racing School. As a private
17 communication, direct mail allows us to talk directly to adult smokers. In this way, direct
18 mail marketing is more focused and results in less spillover to an unintended audience.
19 Direct mail marketing is also valuable because it allows us to segment adult smokers in a
20 variety of ways, including by brand, by those who have responded to our prior coupon
21 offers, and by geography. In this way we are able to target our cigarette brand marketing
22 communications even more precisely for specific mailings.

1 Q. What are JD-053406, JD-053407, JD-053409, JD-053410, JD-053411, JD-
2 053412, JD-053413 and JD-053414?

3 A. These are examples of direct mail pieces sent to Marlboro, Parliament and
4 Virginia Slims adult smokers who are on our Adult Smoker Database.

5 XV. SPONSORSHIPS AND EVENT MARKETING

6 A. PRE-MSA SPONSORSHIPS

7 Q. What is a sponsorship?

8 A. A sponsorship is a form of marketing where a company or a brand pays to have its
9 name linked with an activity or event. A sponsorship can be exclusive, where the
10 company or brand is the only sponsor, or it can be shared with other companies or brands.
11 The goal of a sponsorship is to link your company or your brand with a team or event that
12 your consumers are interested in.

13 Q. Has Philip Morris USA engaged in sponsorship marketing?

14 A. Yes. Prior to the MSA, we had several sponsorships. Under the MSA, we are
15 now restricted to a single sponsorship.

16 Q. What sponsorships did Philip Morris USA have prior to the MSA?

17 A. Prior to the MSA, we had sponsorships for several of our major brands. Probably
18 the most recognizable sponsorship we had was Virginia Slims Tennis. Prior to the MSA,
19 Philip Morris USA also had sponsorships for other brands, including Marlboro Racing,
20 Merit Bowling and B&H Blues concerts.

21 Q. What role did these sponsorships play in the marketing of Philip Morris
22 USA's cigarette brands?

1 A. Sponsorships are also part of the promotions element of the brand value equation
2 I described earlier. All of these sponsorships were designed to build equity for our
3 cigarette brands by associating them with events that adult smokers enjoyed. In
4 connection with the sponsored events, we could also reward adult smokers with things
5 like tickets or merchandise associated with the event.

6 B. POST-MSA SPONSORSHIP OF MARLBORO TEAM PENSKE

7 Q. How did the MSA restrict Philip Morris USA's involvement in brand name
8 sponsorships?

9 A. The MSA restricts Philip Morris USA to one brand name sponsorship in any
10 twelve-month period. In addition, the MSA places some restrictions on our activities in
11 connection with that sponsorship. For example, we cannot combine tobacco product
12 advertising with sponsorship advertising and we can only put up outdoor advertising for a
13 sponsorship within a certain number of days of the sponsored event.

14 Q. What did Philip Morris USA select as its brand name sponsorship following
15 the MSA?

16 A. The Marlboro brand had sponsored open wheel racing for years, and we decided
17 to retain this sponsorship. Immediately following the MSA, Philip Morris USA selected
18 the sponsorship of the Marlboro Team Penske entry in the CART Racing League and
19 activities associated with that entry. This sponsorship provided us with opportunities to
20 invite our wholesale and retail customers and those adult smokers that reside on our
21 Adult Smoker Database to join us at the race. Today, Philip Morris USA sponsors the
22 Marlboro Team Penske entry in the Indy Racing League along with activities associated
23 with that entry.

1 Q. Why did Philip Morris USA select Marlboro Team Penske Racing as its
2 brand name sponsorship?

3 A. Auto racing, with its sense of spirit and adventure, is a sport that fits with the
4 positioning of Marlboro. We hear from Marlboro adult smokers that they enjoy racing,
5 and open wheel racing is an event that many adult smokers attend. Marlboro's
6 sponsorship of an open wheel racing team gives us the opportunity to provide those
7 smokers with an experience they will remember and, ideally, a relationship with the
8 racing team that will translate into a stronger relationship with the Marlboro brand.

9 Q. Does open wheel racing attract a significant number of persons under the age
10 of 18?

11 A. Not according to the statistics we have seen. There are two things we have looked
12 at with respect to whether open wheel racing is an appropriate event for us to be involved
13 with. The first is the demographics of the attendees at open wheel racing events. We
14 also look at other information available as to the positioning of the series and events, as
15 well as information as to the identity and goals of other participants involved in open
16 wheel racing in particular.

17 Q. What did Philip Morris USA determine with respect to the demographics of
18 the audience for open wheel racing?

19 A. We have received statistics on the demographics of both CART and Indy car
20 racing showing that over time, the percentage of spectators under the age of 18 has
21 ranged from as low as 5.5 percent to as high as 15 percent. These statistics also show that
22 the vast majority of attendees at such races are over 25. These figures satisfied us that the
23 attendees at open wheel races are predominantly adults..

1 C. PHILIP MORRIS USA'S EFFORTS TO REDUCE THE EXPOSURE OF
2 ITS RACING SPONSORSHIP TO PERSONS WHO ARE UNDER LEGAL
3 AGE

4 Q. Does Philip Morris USA take any steps to try to avoid appealing to persons
5 who are under legal age with the Marlboro Team Penske sponsorship?

6 A. Yes. Before each race, we conduct a complete review of everything that is
7 scheduled to occur during the race weekend. The Marlboro Team Penske team puts
8 together a binder with a minute-by-minute schedule of events for the race weekend. We
9 then go through the binder in detail to ensure that none of the scheduled events is
10 inconsistent with our efforts to eliminate youth-oriented activities at the track. Many of
11 the issues that come up at races tend to arise at the last minute and must be handled
12 without much, if any, lead time. We have people at each race that are aware of both our
13 internal policies and our MSA obligations, and one of their primary concerns is to make
14 sure that the race is run in accordance with those policies and obligations. In addition, we
15 take steps to make sure that the publicity surrounding the races and our team does not run
16 afoul of either our internal policies or our MSA obligations.

17 Q. What steps has Philip Morris USA taken with respect to the age of race car
18 drivers?

19 A. We have made sure that all drivers participating in both the main races and any
20 support races, whether for our team or another race team, are 18 years of age or older. In
21 fact in 2001, with our team's championship on the line, we were poised to pull our cars
22 and signage out of a race after we learned that a sixteen year old was planning to
23 participate as a driver in a support race that weekend. Ultimately, the sixteen year old did
24 not participate in the supporting race.

1 Q. Has the company changed its policy with respect to being the title sponsor of
2 races?

3 A. Yes. At one time, we were the title sponsor of around two to three races each
4 year. What that means is that the name Marlboro was part of the name of the race and
5 that the winner's check was presented on behalf of Marlboro. In 2001, we made the
6 decision not to be the title sponsor of any race. The practical effect of this decision was
7 that the visibility of the Marlboro name in conjunction with those races was reduced
8 substantially.

9 D. BAR NIGHTS

10 Q. I am going to direct your attention to the following Proposed Findings of
11 Fact filed by the Government with this Court: No. 4211 and 4213. "Defendants
12 also continue to market to youth by holding and advertising events such as "Bar
13 Nights" that appeal to young people." "Defendants often promote their events – and
14 therefore their cigarette brands – in free newspapers, available to anyone. For
15 example, in 2002, Philip Morris continued to place advertisements for its events
16 program Marlboro Bar Nights in "alternative" newspapers, such as the *Village*
17 *Voice*, that are free and widely distributed." Does Philip Morris USA use its Bar
18 Nights marketing activities, in any way, to market its cigarette products to underage
19 people?

20 A. No.

21 Q. Does Philip Morris USA still conduct bar nights?

22 A. Yes.

23 Q. What is a bar night?

1 A. A bar night is a marketing event conducted in bars where admission is strictly
2 limited to adults 21 years of age and older. Philip Morris USA requires that the bar
3 follow a stringent regimen in order to limit admission to adults 21 years and older on the
4 night of the event. Until 2003, Marlboro Bar Nights were publicized events conducted in
5 bars at which our vendors would conduct various activities, including music, sweepstakes
6 and other promotions. Today, Philip Morris USA conducts a much different version of
7 bar nights. For example, Philip Morris USA no longer advertises bar night events and
8 does not place signs at the bars. Instead, Philip Morris USA conducts bar nights to
9 generate names for the Adult Smoker Database. A Philip Morris USA vendor surveys
10 the bar patrons to determine if they are smokers and interested in signing up for the Adult
11 Smoker Database. If a smoker agrees to sign up for the Database, the vendor offers the
12 smoker a cigarette lighter which does not have the name of any cigarette brand on it. In
13 addition, on occasion our vendors sell cigarettes to the bar patrons or, in the case of bars
14 that sell cigarettes, ensure that our brands are available.

15 XVI. PRICE AND PRODUCT PROMOTIONS

16 A. OVERVIEW OF CIGARETTE PRICES: 1980s TO PRESENT

17 Q. Does Philip Morris USA sell cigarette brands directly to smokers?

18 A. No. We sell the majority of our cigarettes to wholesalers and distributors, who
19 then sell those cigarettes to retailers. We also sell directly to a few large retailers, like
20 large supermarket chains. The retailers then sell those cigarettes to smokers.

21 Q. Does Philip Morris USA determine the price that retailers charge for your
22 cigarette brands?

1 A. No. We determine the list price at which our cigarette brands are sold to
2 wholesalers and distributors.

3 Q. Do you have any role with respect to setting the list price for Philip Morris
4 USA's cigarette brands?

5 A. Yes. I evaluate cigarette prices and the overall cigarette market in order to make
6 recommendations to our CEO about how we should set the list price for our cigarette
7 brands.

8 Q. Generally speaking, what are some of the factors that may influence how
9 Philip Morris USA sets the list price for its cigarette brands?

10 A. We look at a number of different factors, including the marketplace and how our
11 brands are performing in that marketplace, as well as certain external events that may
12 affect the amount adult smokers are willing to pay for cigarettes, such as the strength of
13 the economy.

14 Q. Does Philip Morris USA set the same list price for all of its cigarette brands?

15 A. No. We have different list prices for our premium brands and our discount
16 brands.

17 Q. If Philip Morris USA does not sell its cigarette brands directly to smokers,
18 why does Philip Morris USA consider what adult smokers are willing to pay for
19 cigarettes when setting its list prices?

20 A. Recall the brand value equation I described earlier. Our primary focus is on our
21 premium brands, like Marlboro, Parliament and Virginia Slims, because those are the
22 brands where our profit margin is higher. In setting list prices for our cigarette brands,
23 we have to determine how much adult smokers are willing to pay for our premium

1 brands. This is in part based on how adult smokers evaluate price in the context of the
2 other elements of the brand's value equation: product, packaging, positioning and
3 promotion. But it is also influenced by the price gap.

4 Q. What is the price gap?

5 A. The price gap is the differential between our premium brands and the lowest
6 priced brands in the marketplace. That differential is something we watch closely
7 because adult smokers are only willing to pay so much more for our premium brands. If
8 the price of our premium brands goes beyond the additional value that adult smokers
9 believe they receive from those brands, in other words, if the price gap becomes too
10 large, then our premium brands may start to lose market share to the discount category or
11 cheaper brands. We carefully track the price gap between Marlboro and the lowest
12 priced brands in the marketplace. If the price gap grows too large, we have determined
13 that Marlboro's share can be negatively impacted.

14 Q. We will come back to the price gap. But first, let me focus you on list prices.
15 Since 1983, have there been any trends with respect to whether the list price of
16 Marlboro cigarettes has increased, decreased or remained the same?

17 A. Yes. The list price has, with one exception in the early nineties, increased
18 consistently over that period.

19 Q. Let me show you JD-050604?

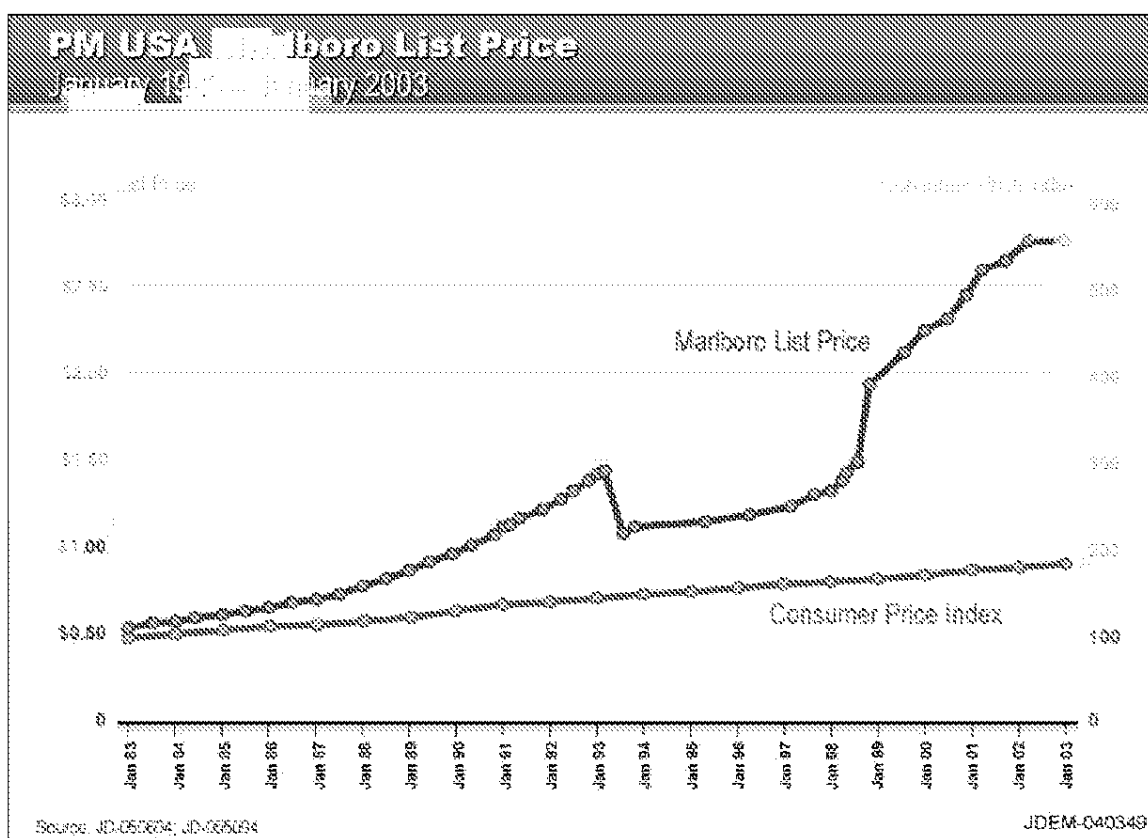
20 A. This is a summary of Philip Morris USA's list price for Marlboro, from January,
21 1983 to January, 2003.

1 Q. Excluding for purposes of this question the exception you referred to in the
2 early 1990s, at what rate has your list price of Marlboro cigarettes increased over
3 that time period?

4 A. The list price of Marlboro cigarettes has risen at a rate well in excess of inflation.

5 Q. Let me show you JDEM-040349. Does this exhibit illustrate what you just
6 described?

7 A. Yes, it does.



8
9 Q. Is the list price, as set by Philip Morris USA, the same price that smokers will
10 pay for your cigarette brands at retail?

11 A. No. The retail selling price is different than the list price.

12 Q. What factors affect the retail selling price for cigarettes?

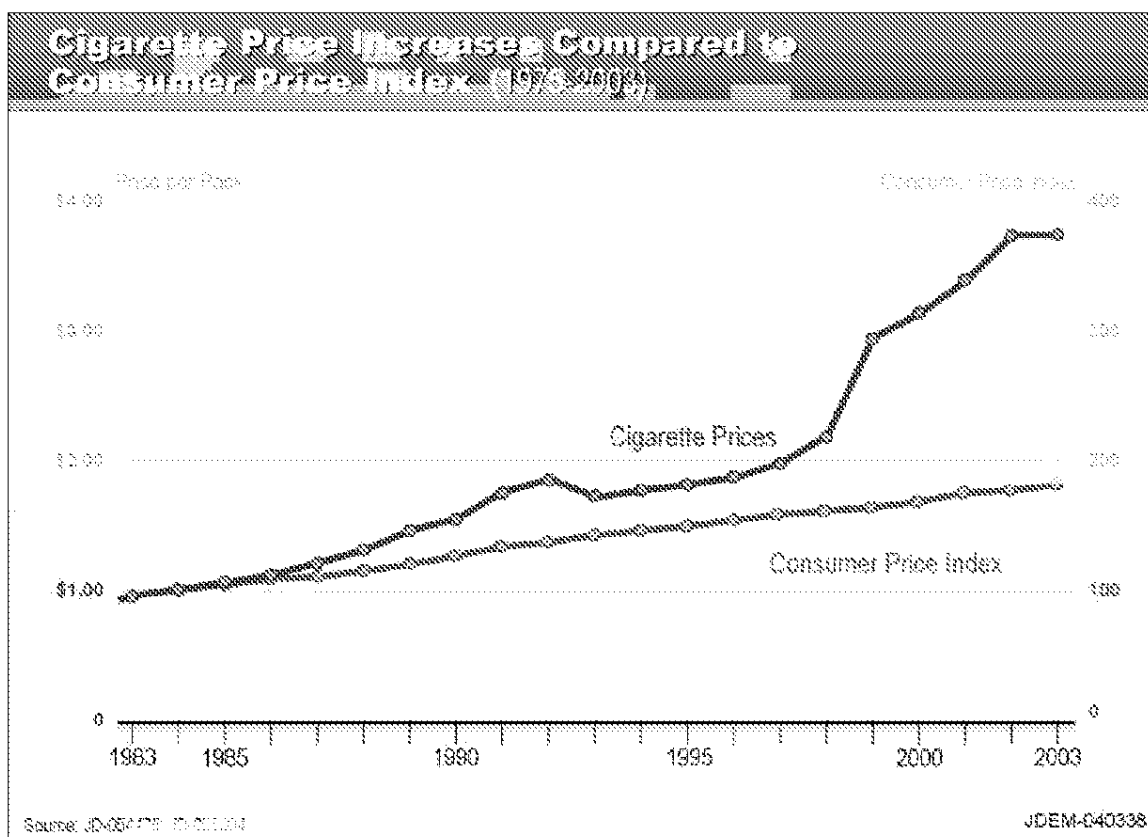
1 A. Several factors, including wholesaler and retailers margins, state excise taxes and
2 our own price promotions.

3 Q. Has the retail selling price for Philip Morris USA's cigarette brands also
4 increased?

5 A. Yes. Retail selling prices have also increased at a significant rate.

6 Q. Let me show you JDEM-040338. Does this document reflect cigarette price
7 increases at retail as compared to the Consumer Price Index during this same time
8 period?

9 A. Yes. And it shows once again that the retail selling price of cigarettes has
10 increased at a rate well in excess of inflation.



1 Q. Does Philip Morris USA track the average pack selling price for Marlboro
2 and its other brands?

3 A. Yes. We subscribe to a data service that gives us this information for
4 convenience store sales. As I have discussed, this is important marketplace information.

5 Q. Let me show you JD-048585 and direct your attention to page 8 of the
6 exhibit. Is this chart an example of Philip Morris USA's tracking of Marlboro retail
7 selling prices in convenience stores?

8 A. Yes.

9 Q. Can you please explain this chart to the Court?

10 A. Yes. Despite a decline in price in early 1993, which I will talk about next,
11 Marlboro's price in 2001 was approximately \$1.03 per pack more than it was eight years
12 before.

13 Q. Let me direct your attention to JD-050275 and in particular the page Bates
14 numbered PM3000554438. What does this show?

15 A. This shows that as of March 29, 2003, the average pack price for Marlboro in
16 convenience stores was \$3.48. Putting this information together with the information I
17 explained in the prior question and answer, this means that the average pack price for
18 Marlboro in convenience stores has gone from approximately \$2.24 in 1993 to \$3.48 in
19 2003 – an increase of \$1.24 per pack.

20 B. MARLBORO FRIDAY

21 Q. What was the exception you referred to in the early 1990s to the overall trend
22 of cigarette list price increases?

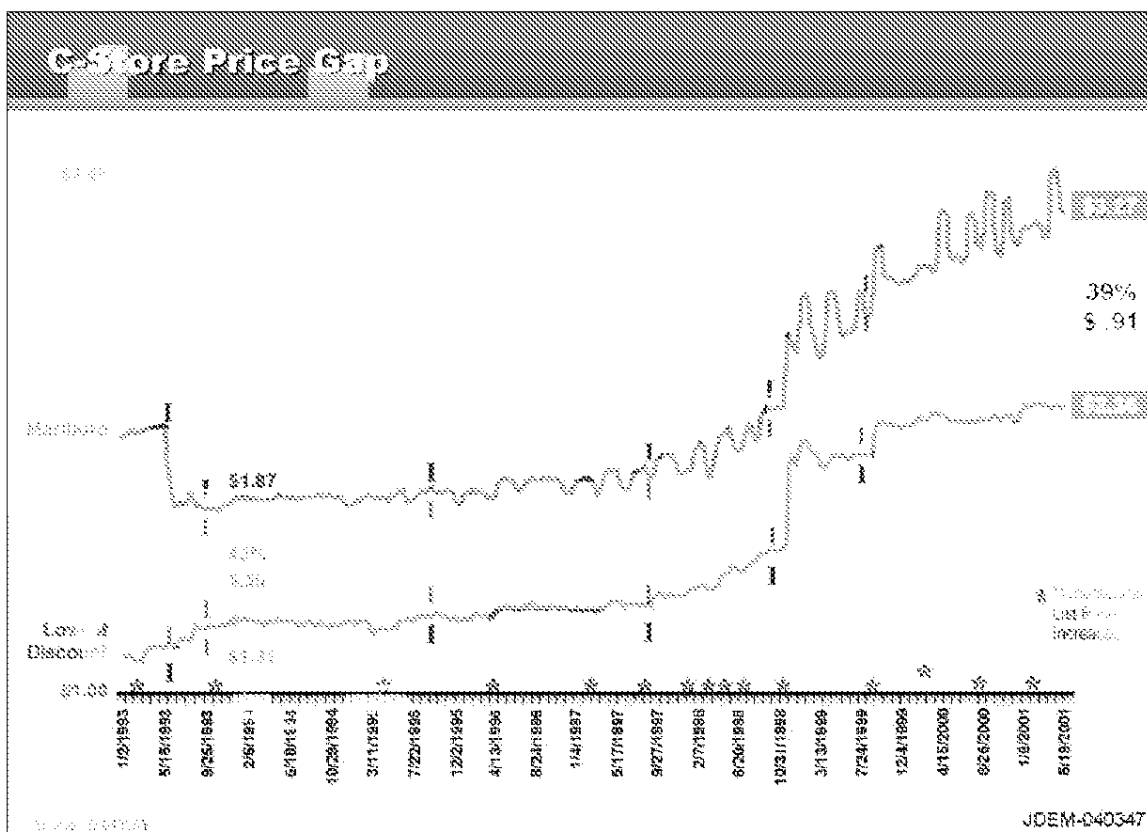
1 A. I was referring to what is known as Marlboro Friday, which refers to some
2 dramatic pricing initiatives we took in 1993 that significantly lowered the price of
3 Marlboro and our other premium brand cigarettes. This bold price initiative sent
4 shockwaves through the entire financial community.

5 Q. Can you please explain how this bold and dramatic pricing initiative came
6 about?

7 A. Yes. In the early 1990s, a few things were going on that dramatically affected
8 adult smokers' purchasing patterns. The economy was slowing down and consumer
9 confidence was waning in the marketplace. At the same time, the price differential
10 between Marlboro and the lowest price cigarette brands had grown to an alarming
11 margin. In addition, the discount cigarette brands were engaging in extremely aggressive
12 price reductions.

13 Q. Let me show you JDEM-040347. What is this demonstrative exhibit?

14 A. This is a color reproduction of page 8 of JD-048585 scaled to fit on the page.



1

2 Q. Can you explain what is meant by the C-Store Price Gap?

3 A. If you look at the far left side of the chart, and do the math, you will see that in
4 January, 1993 there was a 90 percent price gap between the retail price of Marlboro and
5 the retail price of the lowest price discount brand.

6 Q. Would you please explain to the Court the importance of a Marlboro price
7 gap this large.

8 A. At this price gap differential in the market place, Marlboro was losing share to
9 lower price products at an alarming rate.

10 Q. Would you please explain to the Court the impact this price gap had on the
11 growth of the discount brand category.

1 A. As a consequence of this dramatic increase in the price gap, the discount cigarette
2 brand category began growing at an annualized rate of 12 share points, which was up
3 dramatically over the previous year. Conversely, our premium brands, particularly
4 Marlboro, started to lose significant market share to the discount brands in this category.
5 These facts demonstrated that smokers were not willing to pay the 90 percent premium
6 for Marlboro, especially in the weakened economic environment of the time.

7 Q. What did Philip Morris USA do in response to those events?

8 A. We began to examine all of the data we had available to us concerning shipments,
9 share and pricing. By analyzing that data, we determined that Marlboro could once again
10 grow share if its retail price was within 40 percent of the retail price of discount
11 cigarettes. After reviewing the situation, we made the decision to go test this theory in
12 the marketplace.

13 Q. Where did Philip Morris USA run this test?

14 A. We first ran a test promotion in Portland, Oregon, offering \$.40 off of every pack
15 of Marlboro for four weeks. In that time period, Marlboro gained four share points in
16 that market. In light of these results, we eventually made a decision that was widely
17 criticized by industry analysts and others who thought it would spell disaster for the
18 future of Philip Morris USA and the Marlboro brand. In April of 1993, we announced a
19 nationwide retail price discount on Marlboro.

20 Q. Let me show you JD-041431. Would you please explain what this document
21 is?

22 A. This is a copy of an April 2, 1993 presentation to analysts made by our then-
23 President and CEO, William Campbell, concerning the nationwide Marlboro price

1 promotion I just described. In his presentation, Mr. Campbell makes it clear that the
2 price gap between Marlboro and the lowest priced brands had risen to an unprecedented
3 level, that the discount category was growing at an average rate of one share point per
4 month and that Marlboro's market share was in its sixth consecutive month of decline,
5 down over two share points from the prior year. He mentioned our Portland test and
6 explained that every time we narrowed the price gap between Marlboro and the lowest
7 price brands through retail promotions, Marlboro's share of market grew.

8 Q. What is JD-048635?

9 A. This is an internal memo Mr. Campbell sent to Philip Morris USA employees on
10 April 2, 1993 announcing the nationwide Marlboro price discount program. Here too,
11 Mr. Campbell explains that the price discount was driven by a strategy to close the price
12 gap between discount brands and Philip Morris USA's premium brands.

13 Q. How much did that nationwide retail price discount lower the retail price of
14 Marlboro?

15 A. Ultimately, by about \$ 0.40 a pack.

16 Q. Let me show you JD-040639. Would you please tell us what this document
17 is?

18 A. This is a copy of the July 20, 1993 presentation made by Mr. Campbell. In his
19 comments, Mr. Campbell reiterated that the actions we took in April, 1993 had two
20 objectives: to narrow the price gap between premium and discount brands and to reverse
21 the share decline of Marlboro.

22 Q. Does this document reflect the ultimate success of Philip Morris USA's
23 Marlboro Friday pricing strategy?

1 A. Yes. This document shows that Marlboro's share was up 1.1 share points in April
2 and May of 1993, halting 8 consecutive months of Marlboro decline. Likewise, the
3 discount category growth slowed to 0.2 share points a month down from a share point per
4 month prior to that. As a result, this document announces that we will convert the
5 Marlboro retail price discount that was scheduled to end on August 8 to an equivalent
6 wholesale list price reduction.

7 Q. What is JD-048637?

8 A. It is an internal memo Mr. Campbell sent to Philip Morris USA employees on
9 July 21, 1993 announcing the actions we took that month. In it he states that our April 2,
10 1993 pricing initiative put Marlboro back on a growth trend and slowed the growth of the
11 discount category to a third of what it had been.

12 Q. I am going to direct your attention to the testimony of one of the
13 Government's expert witnesses, Frank Chaloupka. Dr. Chaloupka testified that
14 "defendants' knowledge about the effects of price on smoking behavior, their
15 knowledge about how the effects of price-related marketing would affect smoking
16 behavior, particularly among teenagers, how the knowledge about the effects of the
17 greater price sensitivity of teens informs their pricing and price-related marketing
18 decisions.." [F.Chaloupka, Trial Testimony, 8214:7-12] Do you agree with this
19 testimony?

20 A. No, I do not.

21 Q. Were the pricing initiatives Philip Morris USA undertook in April and
22 August of 1993 intended to attract underage smokers to Marlboro?

23 A. Absolutely not.

1 C. PRICE AND PRODUCT PROMOTIONS

2 Q. What is a price promotion?

3 A. It is part of the promotion element of the brand value equation I described earlier.

4 A price promotion is a brand promotion that is by law available only to legal age
5 smokers, whereby they are able to purchase a pack or a carton of that brand at a reduced
6 price. A price promotion can be a retail promotion – that is, it appears at retail in the
7 form of a reduced price for a limited time. We can also offer a price reduction to adult
8 smokers through direct mail – that is, adult smokers 21 and older on our Adult Smoker
9 Database are sent coupons that they can then redeem at retail to purchase cigarettes at a
10 reduced price.

11 Q. What is a product promotion?

12 A. This, too, is part of the promotion element of the brand value equation. A product
13 promotion is another type of retail brand promotion that is available only to legal age
14 smokers. Product promotions typically offer adult smokers an opportunity to buy a
15 specified number of packs or cartons and get a specified number of packs or cartons for
16 free. Product promotions can take various forms. Today we offer primarily two types of
17 product promotions: a buy one, get one free pack promotion or a buy two get one free
18 pack promotion. However, product promotions in 2003 represented only approximately
19 4 percent of Marlboro's volume.

20 Q. Why does Philip Morris USA offer price and product promotions?

21 A. For both, it goes back to the brand value equation. Generally speaking, we offer
22 retail promotions to reward current adult smokers of Philip Morris USA brands to
23 encourage their continued brand loyalty. In addition, we offer retail promotions to entice

1 competitive brand adult smokers to try Philip Morris USA brands or to purchase Philip
2 Morris USA brands on an alternate basis. This goes back to the two objectives of our
3 cigarette brand marketing that I explained earlier: defending our market share and
4 growing that share at the expense of our competitors.

5 Q. I am going to direct your attention to the testimony of one of the
6 Government's expert witnesses, Dean Krugman. Dr. Krugman testified that "the
7 tobacco companies have used a portion of [their advertising and promotion]
8 expenditures to fund advertising and sales promotion programs that reach and/or
9 target teenagers." [D. Krugman Written Direct 31:21 – 32:4.] Do you agree with
10 this testimony?

11 A. I do not.

12 Q. Please explain the basis for your disagreement.

13 A. First of all, we only market our cigarette brands to legal age smokers. So, we do
14 not intend that anyone under legal age take advantage of our price or product promotions.
15 Second, despite our price promotions on Marlboro, it is still substantially more expensive
16 than the lowest price products in the marketplace. For example, JD-050275 at page
17 3000554438, which we looked at before, shows that Marlboro's average price in C-Stores
18 as of March, 2003, was \$1.46 per pack higher than the lowest priced brand in the store.
19 Third, by definition, price and product promotions are only available to adult smokers
20 who may legally purchase cigarettes at retail. Fourth, as I testified earlier, we no longer
21 place advertisements in national magazines.

22 D. PRICE ELASTICITY

23 Q. Are you familiar with the concept of price elasticity?

1 A. Yes. It is an estimate of the rate at which consumption of a product will fall for
2 each percentage increase in the price of that product.

3 Q. Does Philip Morris USA look at price elasticity estimates in setting its list
4 prices for cigarettes?

5 A. Yes.

6 Q. Does Philip Morris USA look at price elasticity rates by age cohort?

7 A. No. In my experience, both for business planning purposes and for purposes of
8 setting list prices I am only aware that we look at an overall price elasticity rate for the
9 cigarette category.

10 Q. What is that overall price elasticity rate for the cigarette category?

11 A. The rate that we have consistently calculated and used since 1987 is 0.28. This
12 means that for every 10 percent increase in cigarette prices at retail, cigarette volume will
13 decline approximately 2.8 percent.

14 Q. Let me direct your attention to another Proposed Finding of Fact filed by the
15 Government in this case, number 4142. "Generally, young people are two to three
16 times more sensitive to price than adults. Estimates from a recent published study
17 of youth smoking initiation indicate that a 10 percent increase in cigarette prices
18 would cause an additional 170,000 high school smokers to stop smoking and that
19 such an increase would also reduce the number of youth who become daily smokers
20 by more than 88,000 teens each year." Do you agree with the statement that
21 "[g]enerally, young people are two to three times more sensitive to price than
22 adults"?

23 A. I do not believe that is a correct statement.

1 Q. Let me show you JD-054452. This is the National Household Survey on Drug
2 Abuse. If you go to page 40, this document sets forth the three brands that
3 accounted for most of youth cigarette smoking in 2001. The top three are Marlboro,
4 Newport and Camel, and if you add the percentages up, it says that 87.4 percent of
5 youth smoke those brands. Do you see that?

6 A. Yes.

7 Q. Are Marlboro, Newport and Camel premium priced brands?

8 A. Yes.

9 Q. Have you seen other reports prepared by the public health community that
10 show that kids smoke the most expensive brands of cigarettes.

11 A. Yes, I have.

12 Q. If kids smoke the most expensive brands of cigarettes, how can they be the
13 most price sensitive purchasers of cigarettes?

14 A. They cannot be.

15 Q. Is Marlboro's retail price lower today than it was prior to the MSA?

16 A. No. As I said earlier, the retail price of Marlboro is substantially higher today
17 than it was prior to the MSA.

18 Q. Why is Philip Morris USA offering more price and product promotions
19 following the MSA?

20 A. It goes back to the dramatic increase in retail selling prices I described earlier. In
21 addition, in 2002 there were approximately 102 manufacturers and/or importers selling
22 cigarettes in the United States marketplace. The vast majority of these companies, what
23 we call All Other Manufacturers (AOM), were offering cigarette brands based solely on

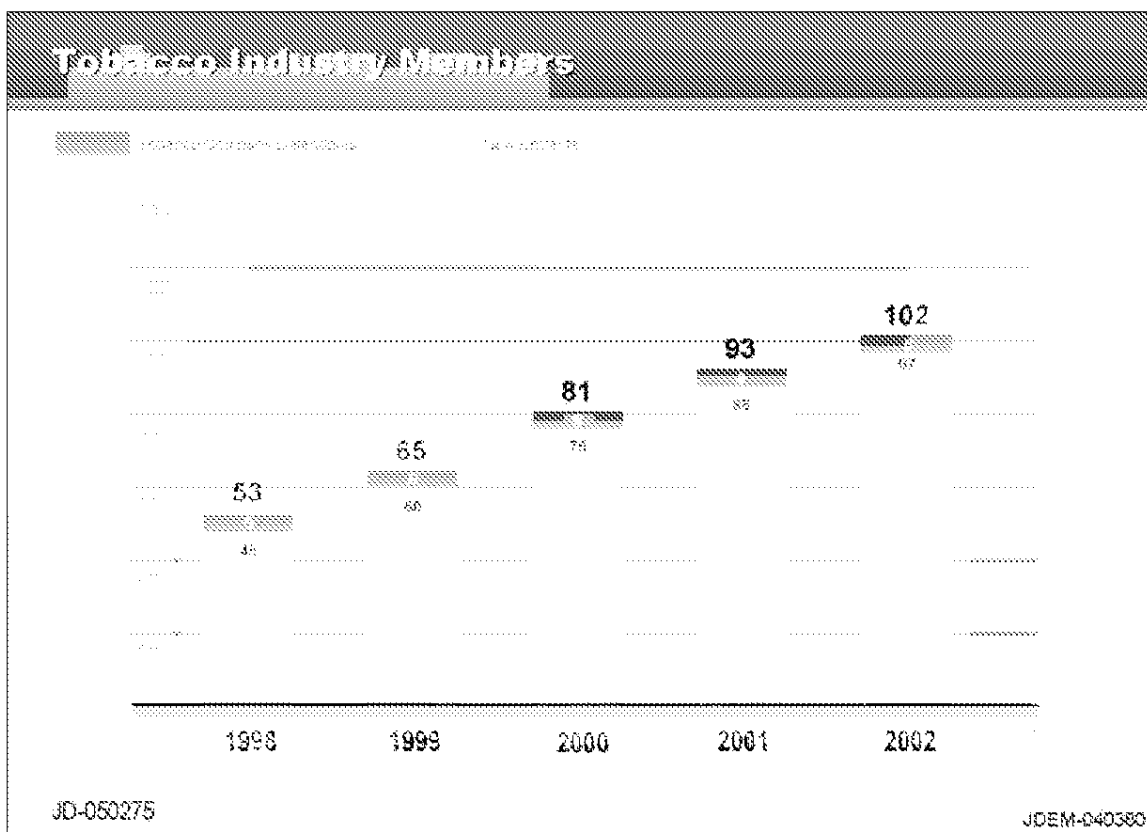
1 significantly lower prices. To compete with the lower priced options flooding the
2 marketplace, we continued to invest in all the elements of the brand value equation.
3 Despite this increased spending at retail, Marlboro's net selling price in convenience
4 stores was still approximately 45-49 percent higher than the lowest priced cigarette brand
5 available in convenience stores.

6 Q. How are the vast majority of these manufacturers able to offer such lower
7 prices?

8 A. There are two primary reasons. First, the vast majority of these manufacturers are
9 not signatories to the MSA, and therefore, do not have the same cost burden as we do.
10 Second, based on my business experience, it my understanding that the vast majority of
11 these manufacturers do not have the same cost structure, including costs for research and
12 development.

13 Q. Let me show you JDEM-040380. What is this document?

14 A. It is the approximate number of manufacturers and importers selling cigarettes in
15 the marketplace. The data are taken from the 2003 state of the business presentation,
16 described above.



1

2 Q. Does this document reflect the growth of AOMs since 1998?

3 A. Yes, it shows that during this time period the new entries into our marketplace
4 doubled.

5 Q. Let me show you JDEM-040381. What is this document?

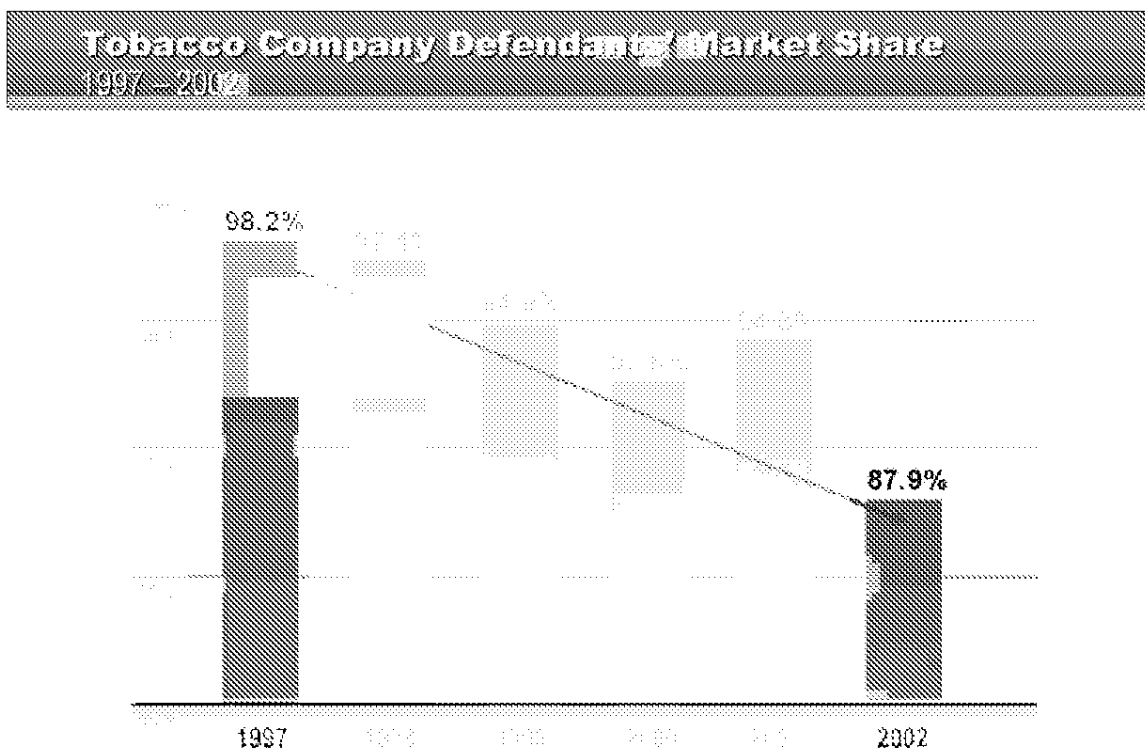
6 A. This demonstrative shows information derived from PriceWaterhouse MSA Audit
7 documents. It shows the tobacco company defendants' declines in combined market
8 share since the MSA, which is in large part attributable to the increase in the number of
9 AOM's during this time.

10 Q. Does Price Waterhouse prepare a document on which this exhibit is based?

11 A. Yes. Pursuant to the terms of the MSA, Price Waterhouse prepares periodic
12 reports on the state of the market and the industry.

1 Q. As part of your duties, are you familiar with these reports and their
2 contents?

3 A. Yes.



4 JD-052903; JD-065406

JDEM-040381

5 Q. How has AOM market share changed since 1998?

6 A. According to PriceWaterhouse, the independent auditor under the MSA, for the
7 year immediately prior to when MSA was signed, 1997, AOM had 1.8 percent of the
8 market. In 2002, AOM had 12.1 percent of the market.

9 Q. What do you believe would happen if Philip Morris USA did not offer your
10 current level of price and product promotions to adult smokers?

11 A. We would be severely crippled in our ability to compete with AOM. Keep in
12 mind that in a declining market, share gains come at the expense of other market players.

1 Thus, while AOM share has risen, that share has come at the expense of the other
2 manufacturers that existed in the marketplace prior to the MSA, including Philip Morris
3 USA. Were we not able to offer price and product promotions to compete in today's
4 market, we anticipate that we would lose market share.

5 XVII. MARKETING OF LOW TAR CIGARETTES

6 A. BRAND DESCRIPTORS

7 Q. What are brand descriptors?

8 A. Brand descriptors are terms like "lights," "ultra lights," "milds" and "mediums."

9 Q. Does Philip Morris USA use brand descriptors in marketing its cigarette
10 brands?

11 A. Yes, we do.

12 Q. What is Philip Morris USA's position on the purpose that brand descriptors
13 serve in its marketing of cigarette brands?

14 A. Brand descriptors provide smokers with a way to compare and distinguish
15 cigarette brands based on strength of taste and flavor and based upon where they fall
16 within FTC-measured tar ranges.

17 Q. Does Philip Morris USA use FTC measured tar and nicotine ratings in its
18 cigarette brand advertising?

19 A. Yes.

20 Q. Why does Philip Morris USA do this?

21 A. It is my understanding that the tobacco companies have been required to place the
22 FTC measured tar and nicotine ratings in all cigarette brand advertising since
23 approximately 1970.

1 Q. Is there any place where smokers can go to compare the tar and nicotine
2 numbers for various cigarettes?

3 A. Smokers can go to our website, where they can look up the FTC numbers for
4 Philip Morris USA cigarette brand packings. In addition, we provide a means for
5 smokers to find the FTC numbers for non-Philip Morris USA cigarette brand packings.
6 From our website, there is a link to the FTC website page that contains the most recent
7 list of tar and nicotine numbers for all brands and line extensions, as published by the
8 FTC.

9 B. THE IMPORTANCE OF TASTE

10 Q. In the market research Philip Morris USA conducts among legal-age
11 smokers, do you ever hear smokers talk about the taste of cigarettes?

12 A. We almost always hear smokers talk about taste.

13 Q. Based on your consumer research how important is cigarette taste to adult
14 smokers?

15 A. Taste is probably the single most important factor in an adult smoker's brand
16 choice.

17 Q. Does the concept of cigarette taste include several different components?

18 A. Yes, it does.

19 Q. When Philip Morris USA develops new cigarette products, does it monitor
20 the various components of taste in order to determine consumer acceptability?

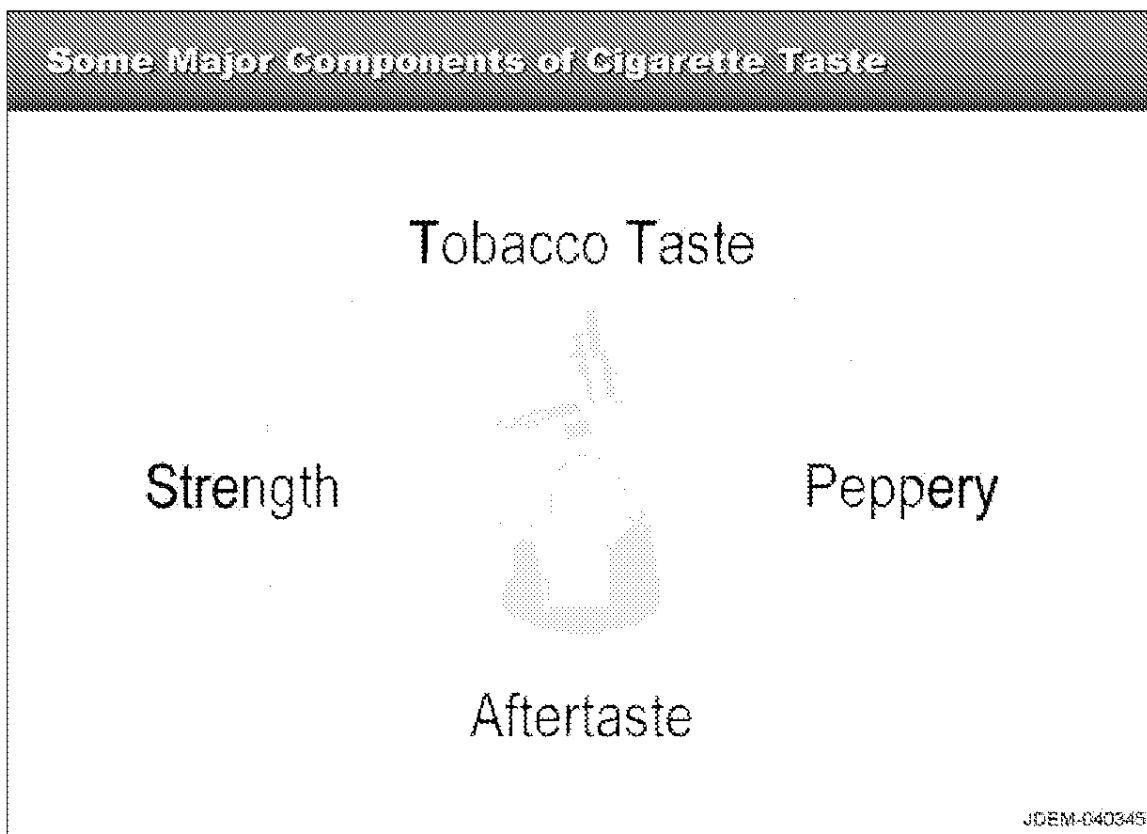
21 A. Yes, we do.

22 Q. Have you helped to prepare a demonstrative concerning the different
23 components of cigarette taste?

1 A. Yes, I have.

2 Q. Let me show you JDEM-040345. Please explain what this demonstrative
3 shows.

4 A. This chart sets forth some of the major components of cigarette taste that Philip
5 Morris USA monitors with our internal panel in developing new cigarette products and in
6 testing existing products.



7
8 Q. I want to take you through each of the components you have listed on this
9 chart. What are the components you have listed there?

10 A. The components are: tobacco taste, peppery, aftertaste and strength.

11 Q. What is tobacco taste?

1 A. As a general matter, it is the taste and aromatic perception typical of tobacco
2 while smoking.

3 Q. What is peppery?

4 A. It's the tingling sensation in your mouth and on your tongue while smoking.

5 Q. What is aftertaste?

6 A. The taste left in mouth after smoking.

7 Q. What is the final component, strength?

8 A. The overall intensity or strength of the cigarette smoke in the mouth, throat, chest
9 and nose.

10 Q. In your market research, do smokers also talk about differences in strength
11 of taste as between cigarettes that are full flavor, lights and ultra lights?

12 A. Yes. Those are the taste distinctions that smokers talk about most. For example,
13 we often hear from smokers who prefer full flavor cigarettes that they think light and
14 ultra light cigarettes taste too light or too weak. We often hear from smokers who prefer
15 light cigarettes that they think full flavor cigarettes taste too strong, but that they think
16 ultra lights cigarettes taste too light or too airy.

17 Q. Based on what you have learned from market research, do you believe that
18 there is a relationship between taste and whether a cigarette is marketed as a light,
19 an ultra light or something in between?

20 A. Yes, I do.

21 Q. Based on what you have learned from market research, do some adult
22 smokers choose light cigarettes because they prefer the lighter taste of those
23 cigarettes?

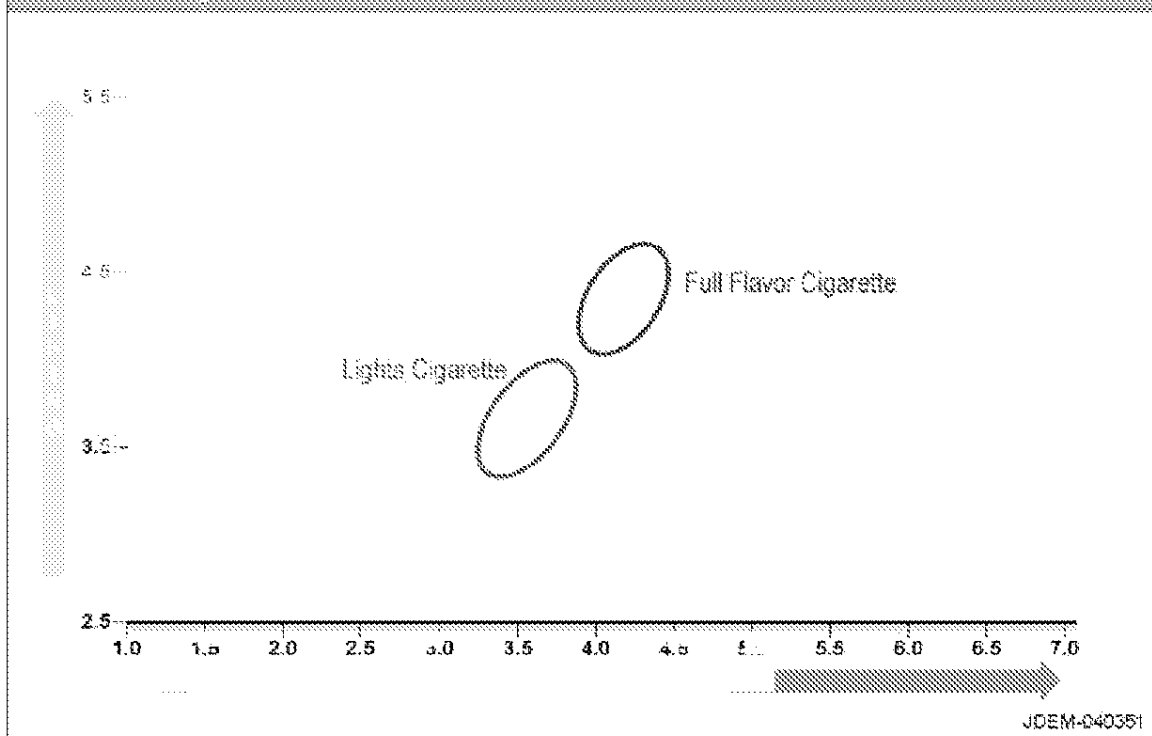
1 A. Yes, we hear that from many adult smokers. Adult smokers routinely tell us that
2 they have strong preferences between cigarettes based on strength of taste – in other
3 words, how strong or light the cigarettes taste. And adult smokers' evaluations of various
4 cigarettes based on strength of taste have a direct correlation to whether the cigarette is a
5 full flavor, light or ultra light cigarette – or something in between those major categories.
6 This is most obvious when we do blind testing of cigarettes with adult smokers. Even
7 when they do not know the descriptor for the cigarette they are testing, most adult
8 smokers' preferences of test cigarettes are consistent with what they tell us about their
9 strength of taste preferences between full flavor, light and ultra light cigarettes.

10 Q. Let me show you JDEM-040351 and JDEM-040350. Have you helped to
11 prepare these charts.

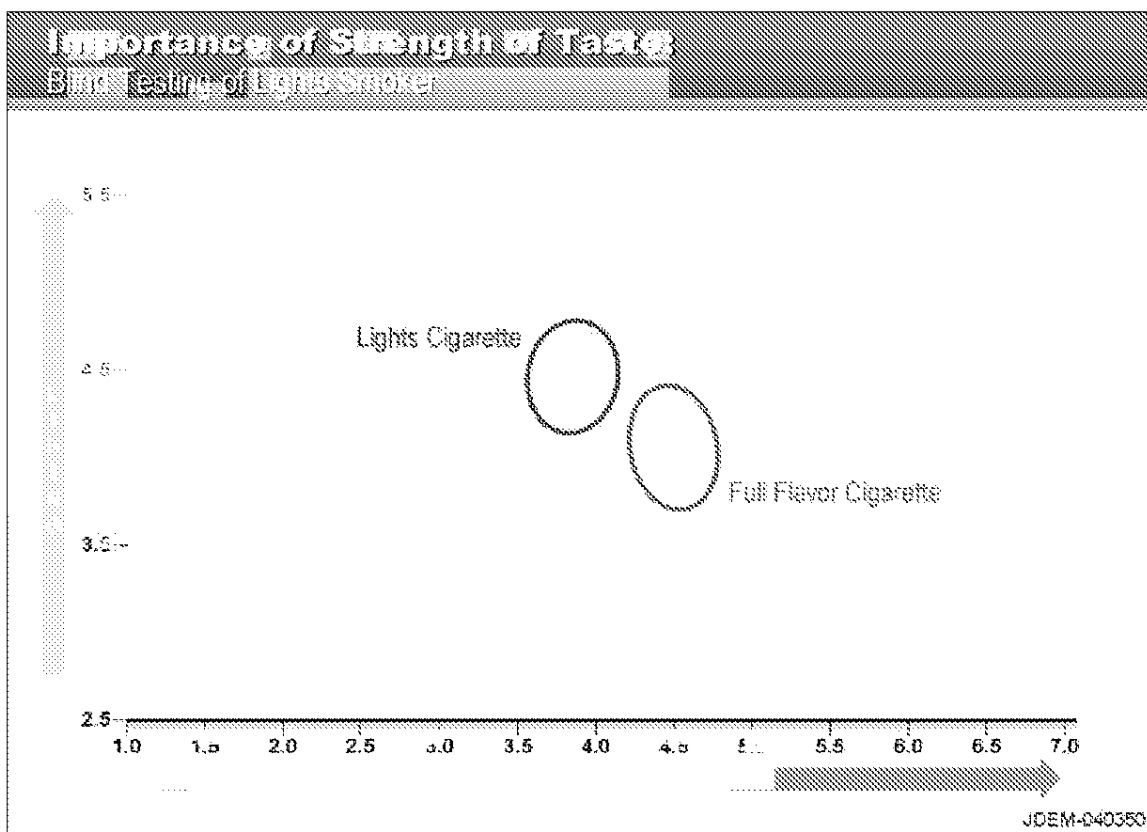
12 A. Yes.

Importance of Strength of Taste

Blind Testing of Full Flavor Smoker



1



1

2 Q. Would you please generally describe what these charts reflect?

3 A. These charts illustrates the importance of flavor we have been discussing –
4 strength of taste. For each chart, the vertical axis represents "Liking," and the horizontal
5 axis represents "Strength."

6 Q. Please explain what the ellipses represent on each chart?

7 A. Each ellipse represents the range of responses we receive from our panelists of
8 smokers, mapping liking scores versus strength of taste. In each chart, the red ellipse
9 represents the range of scores we have receive from our panelists when they smoke their
10 own brand. The blue ellipse represents the range of scores we receive from our panelists
11 when they smoke the brand we are testing.

12 Q. What is represented on the charts?

1 A. The first chart, JDEM-040351, reflects that when most full flavor panelists
2 smoked the lighter cigarettes, they gave that product a reduced liking score and lesser
3 strength score. The second chart, JDEM-040350, reflects that when most lights panelists
4 smoked the full flavor cigarettes, they gave that product a reduced liking score and a
5 greater strength score. Even though these panelists did not know what cigarettes they
6 were smoking, the strength of the test cigarettes influenced how much they liked each
7 cigarette.

8 Q. Why are these results significant to Philip Morris USA?

9 A. These results are significant, because they establish a clear correlation between
10 liking and strength of taste. In other words, adult smokers measure how much they like a
11 cigarette based in large part upon where that cigarette falls in the strength of taste
12 continuum. For smokers who prefer light cigarettes, they consistently rank the lighter
13 tasting cigarettes higher on the liking scale. Conversely, smokers who prefer full flavor
14 cigarettes consistently rank the stronger tasting cigarettes higher on the liking scale.

15 Q. Have you seen consumer research indicating that some smokers choose low
16 delivery products at least, in part, because they also believe they are less hazardous?

17 A. Yes.

18 XVIII. PHILIP MORRIS USA'S RESPONSE TO PUBLIC HEALTH
19 COMMUNITY CONCERNS ABOUT LOW TAR CIGARETTES

20 Q. Are you generally familiar with the conclusions set forth in NCI Monograph
21 13?

22 A. Yes.

1 Q. Would you please describe some of Philip Morris USA's activities in response
2 to NCI Monograph 13?

3 A. Yes. Philip Morris USA has carefully analyzed Monograph 13 and taken a
4 number of steps in response. These steps have included a public communications
5 campaign, engagement with the FTC, CDC and other regulatory bodies, changes to our
6 packaging, as well as product research efforts.

7 Q. Let me show you what has been identified as JDEM-040176. First, let me say
8 that this exhibit has been described in some detail by other Philip Morris USA
9 witnesses. For our purposes, however, do items 5-10 on this chart set forth some of
10 the ways that Philip Morris USA responded to Monograph 13?

11 A. Yes, they do.

**Philip Morris USA Consumer Education Efforts:
FTC Numbers and Product Descriptors**

1. Proposed Consumer Education Campaign To FTC, 1997.
2. 1999 Philip Morris USA Website.
3. Website Awareness Efforts.
4. Philip Morris USA Disclosure Placed In All Advertising, 2000:
"The amount of tar and nicotine you inhale will vary depending on how
you smoke the cigarette."
5. Website Updates In Response To Publication Of Monograph 13.
6. September 2002 Philip Morris USA Petition To FTC. Requested Mandatory
Consumer Information.
7. Package Onsert, November 2002. Package Onsert Repeated 2003 And 2004.
Package Onsert Planned For 2005.
8. Freestanding Newspaper Insert, November 2002.
9. National Television And Radio Advertising Campaign Launched In 2003.
10. PM USA Supports FDA Regulation, Including Regulation Of Product Descriptors.

JDEM-040176

1 Q. I do not intend to have you repeat details regarding these items. However,
2 are there other things Philip Morris USA did to respond to Monograph 13 not listed
3 on this particular chart?

4 A. Yes, there are.

5 Q. Can you give me an example?

6 A. We made a change in cigarette brand packaging for low tar cigarettes.

7 Q. Please describe the change made to the packaging for your low tar
8 cigarettes?

9 A. Beginning in 2003, we removed phrases such as "lowered tar and nicotine,"
10 "lower tar and nicotine" and "low tar and nicotine" from our packages of cigarettes.

11 Q. Why did Philip Morris USA take this step?

12 A. We were trying to respond to concerns expressed by the public health authorities
13 in our continuing effort to be responsible in the marketing of such cigarettes.

14 Q. Is Philip Morris USA conducting any research that will provide additional
15 information with respect to low tar cigarettes?

16 A. Yes. For the past several years, Philip Morris USA has been conducting the
17 largest clinical study ever undertaken to gain information about smokers' exposure to
18 certain constituents in smoke. Obtaining this important information is part of our
19 ongoing efforts to develop products that could reduce smokers' exposure to harmful
20 compounds identified by the public health community. In addition, this study may
21 provide information relevant to whether lower delivery cigarettes do, in fact, reduce
22 smokers' exposure to harmful compounds. Once completed, the Study should give us
23 reliable data concerning, among other things, smokers' actual intake of nicotine and other

1 constituents. Up to this point, we have had to rely on machine testing, such as the FTC
2 machine testing process, for information about tar and nicotine yields. This study is
3 known as the Total Exposure Study.

4 Q. Let me show you JD-050103. What is this document?

5 A. It is a presentation given in 2004 by Dr. Hans Roethig, a Philip Morris USA
6 physician and scientist. Dr. Roethig was hired by Philip Morris USA to direct these
7 clinical studies. This exhibit describes the objectives and status of the Total Exposure
8 Study.

9 Q. In general terms, how is the Total Exposure Study conducted?

10 A. In general, the clinical portion of the study first involved recruiting adult smokers
11 from different tar categories, as defined by the FTC, to participate in this study. We also
12 recruited adult nonsmokers to serve as a control group. Once recruited those smokers
13 and nonsmokers then provided blood and urine samples to be analyzed for the presence
14 of certain biomarkers for exposure. For example, certain biomarkers measure exposure
15 to nicotine. Then, clinical experts collect and analyze the information.

16 Q. Let me show you JD-050249. Please describe what this document is.

17 A. This document is Philip Morris USA's Final Research Protocol for its Total
18 Exposure Study, dated July 19, 2002.

19 Q. Will this document give the Court a clear understanding of the scope and
20 process of Philip Morris USA's Total Exposure Study?

21 A. Yes, it will.

22 Q. What is the current status of the Total Exposure Study?

23 A. Clinical studies have been completed and the data is now being analyzed.

1 XIX. PHILIP MORRIS USA'S EFFORTS TO DEVELOP LESS HAZARDOUS
2 CIGARETTES

3 Q. In the mid- to late 1980's, were you familiar with Philip Morris USA's efforts
4 to develop a cigarette product which removed virtually all nicotine?

5 A. Yes.

6 Q. In connection with Philip Morris USA's effort to develop a cigarette with
7 virtually no nicotine, let me begin with this basic question: Were you generally
8 aware that some segments of the public health community had promoted the
9 concept that a cigarette with very little nicotine would potentially reduce the harm
10 associated with cigarette smoking?

11 A. Yes.

12 Q. Can you please generally describe the events surrounding the development of
13 this product?

14 A. Yes. In the mid-1980's, Philip Morris purchased General Foods which, among
15 other things, manufactured decaffeinated coffee with a process called super-critical
16 extraction. Philip Morris USA scientists developed the concept of using the same process
17 and applying it to tobacco to remove nicotine. During the development process, Philip
18 Morris USA built two pilot plants to test the viability of using the super-critical extraction
19 process to remove nicotine from tobacco. After a great deal of effort, progress was made
20 and Philip Morris USA made the decision to move forward and commercialize the
21 product. This required the construction of a major manufacturing facility near Richmond,
22 Virginia. The facility was exclusively devoted to the manufacturing of this new product.
23 In 1989, Philip Morris USA introduced these de-nicotinized cigarettes under the brand

1 names of Next De-Nic in certain test markets. The Next De-Nic market was followed by
2 a test market launch of Benson & Hedges De-Nic, in order to associate this de-nic
3 concept with a successful existing brand.

4 Q. What happened in these test markets?

5 A. Consumers did not like the taste of the product. Consumers complained that the
6 taste was flat and too mild. Philip Morris USA made an enormous effort to improve the
7 flavor and taste. Philip Morris USA experimented with over 1000 different flavor
8 formulas, but was unable to improve the taste sufficiently to obtain consumer
9 acceptability. Philip Morris USA expended approximately \$300 million in attempting to
10 develop and commercialize this de-nic product. Ultimately, the product was a
11 commercial failure for Philip Morris USA.

12 Q. Let me show you JD-053838. Please tell the Court what this document is.

13 A. This is a Philip Morris USA Benson & Hedges De-Nic test market tracking study
14 conducted in March, 1991.

15 Q. How was this document created?

16 A. It was created with knowledge of the test marketing study.

17 Q. Please tell the Court what this tracking study revealed regarding the taste
18 problem you referenced above?

19 A. On an overall basis, the cigarette received very weak taste scores, primarily
20 because of an overmildness problem.

21 Q. As far as Philip Morris USA's commitment to developing alternative
22 cigarette designs, let me show you Philip Morris USA's 1989 Five Year Plan – JD-
23 055103. I would like to direct your attention to page 13 to this paragraph in the

1 middle of the page: " Aggressive and innovative R&D programs are essential to
2 maintain our pre-eminent position in the cigarette industry over the next five years.
3 Aside from our ongoing work on conventional products, significant developmental
4 emphasis will be placed on concepts which address changing perceptions of smoking
5 such as lowered nicotine, lowered sidestream and alternative smoking articles.
6 Some of these concepts will be ready for test market in the early stages of the plan
7 period. Philip Morris USA will also continue to develop conventional products
8 which expand the appeal of our brands such as Marlboro Ultra Lights and B&H
9 85mm." Is the de-nic project we have been discussing one of the concepts described
10 in this paragraph?

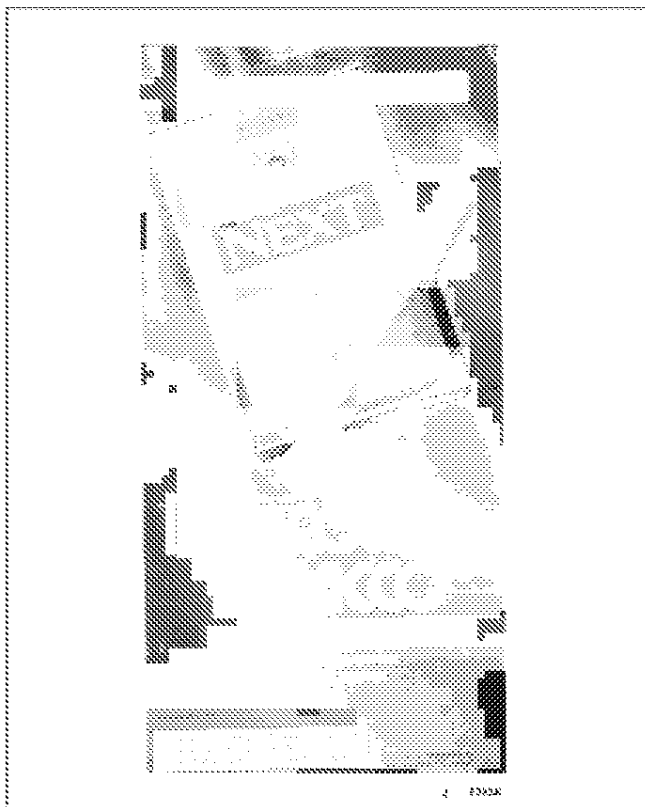
11 A. Yes – it is referred to in this paragraph as "lowered nicotine."

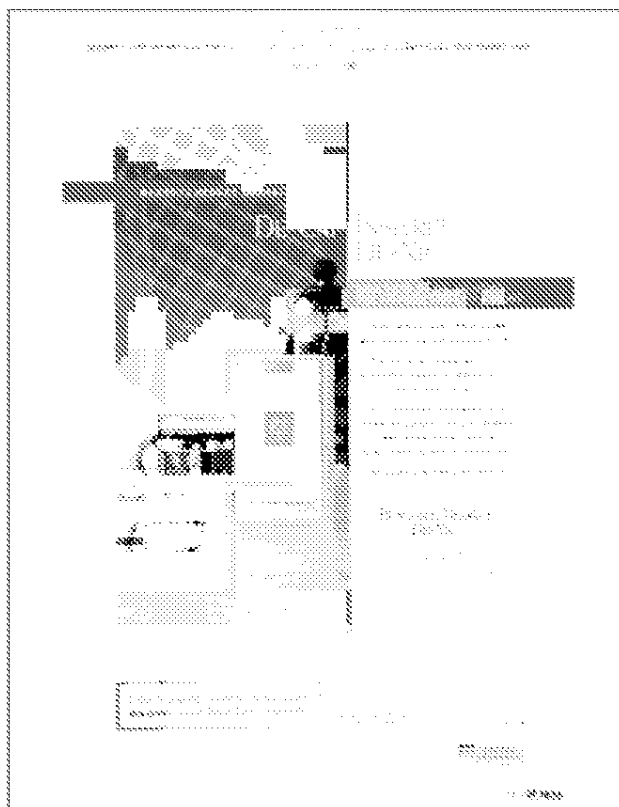
12 Q. Were you involved in the preparation of this plan?

13 A. Yes, in my position as Director of Finance and Planning, I was substantially
14 involved in the preparation of the plan.

15 Q. Let me show you JD-053828 and JD-053835. Please identify these exhibits.

16 A. They are magazine ads we ran for Next De-Nic and Benson & Hedges De-Nic in
17 the test markets.





1

2 Q. Please explain to the Court what Philip Morris USA's marketing strategy
3 was regarding this new de-nic product.

4 A. Philip Morris USA wanted to communicate to consumers that this was a
5 breakthrough product which had removed virtually all of the nicotine from the cigarette.

6 Q. What did Philip Morris USA learn from this failure?

7 A. We learned that no matter how important a technology breakthrough is, taste is
8 still the most important element that the adult smoker requires from a cigarette.

9 Q. The Court has heard testimony from other Philip Morris USA witnesses
10 regarding Philip Morris USA's SCoR program. Is this lesson still relevant today to
11 the SCoR program?

12 A. Yes.

1 Q. Please explain why.

2 A. Consumers still today will not switch their brand of cigarettes, if they do not like
3 the taste, or if it does not meet their taste expectations.

4 Q. Let's go back and give the Court an indication of your involvement with the
5 SCoR program. When did you first become involved with the program?

6 A. My first significant involvement began after I became Senior Vice President of
7 Operations in the fall of 2000. Part of my responsibilities included supervision of the
8 company's research and development efforts.

9 Q. Please explain the general objectives of the SCoR program.

10 A. The general objective is to develop and commercialize cigarettes that may reduce
11 the health risks of smoking by significantly reducing the delivery of smoke constituents
12 identified by the public health community as potentially harmful, while maintaining an
13 acceptable smoking experience for adult smokers. The SCoR program is an extremely
14 complex undertaking. For this reason, we anticipated that it would take several years to
15 accomplish its objectives.

16 Q. Please describe some of the activities undertaken to achieve the SCoR
17 objective during your tenure as Senior Vice President of Operations.

18 A. I appointed a group of engineers and scientists to begin getting ready for
19 commercialization of products using the SCoR technologies. Specifically, that entailed
20 adding additional manufacturing capacity and equipment dedicated to this effort. During
21 this undertaking, new equipment and processes had to be designed and built. In addition,
22 a very large parallel effort was underway in the Research and Development Department
23 to develop specific elements related to this program, such as flavor threads, activated

1 carbon, the use of tobacco with low Tobacco-Specific Nitrosamines and other
2 components. Finally, I directed the implementation of a new infrastructure to integrate
3 all aspects of the program to ensure adequate design inputs, reporting and similar
4 processes.

5 Q. Let me show you JD-050237, JD-050218, JD-050219, JD-050220, JD-050221,
6 JD-050222, JD-050223, JD-050224 and JD-050225. Are these some of the reports
7 regarding the status and progress of the SCOR program over time?

8 A. Yes.

9 Q. What was your responsibility regarding these reports?

10 A. I was the executive sponsor of the program which meant that I had ultimate
11 responsibility for the content of the reports and for all aspects of the commercialization
12 program that they describe.

13 Q. By way of example, let me show you the first page of JD-050225, which is the
14 monthly report dated August 26, 2002. Does that page list the various program
15 elements that needed to be addressed as part of the SCoR program?

16 A. Yes.

17 Q. What were those elements?

18 A. There were eight of them: [1] Product development, [2] Quality system, [3]
19 process and machinery development, [4] Facility design and construction, [5] Machinery
20 procurement and installation, [6] Direct material procurement, [7] Manufacturing systems
21 and logistics and [8] Product positioning and marketing.

22 Q. Do these elements demonstrate the complexity of the SCoR program?

23 A. Yes, they do.

1 Q. Can you describe the progress Philip Morris USA has made in addressing
2 these elements?

3 A. Yes, we have substantially completed work against a number of the elements
4 including equipment design, facility construction, materials identification and
5 procurement, implementation of a quality system and extensive product development. In
6 addition, we have undertaken extensive work on product positioning and consumer
7 research.

8 Q. How many people have worked on the SCoR program?

9 A. Taking into account Philip Morris USA employees as well as employees of
10 various third party vendors such as research facilities, engineering companies and
11 consumer research companies, the number would be in the thousands.

12 Q. How much money has Philip Morris USA invested in the SCoR program to
13 date?

14 A. A conservative estimate would be over \$170 million over the past five years.

15 Q. What is the status of the SCoR program today?

16 A. We continue to devote the full power of our product development, consumer
17 research and marketing resources to commercialize cigarettes using the SCoR-related
18 technologies. While we have made significant progress on the development of a product
19 using SCoR-related technologies, our continuing and significant challenge remains
20 identifying a product that meets consumers' taste expectations. We hope to be able to
21 achieve this objective. This will help meet one of our principle mission goals; to provide
22 adult smokers with smoking pleasure while reducing the harm caused by smoking.

23 Q. Thank you Mr. Beran.